Pratt's

Journal of Bankruptcy Law

AN A.S. PRATT & SONS PUBLICATION APRIL/MAY 2013

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207, For subscription information and customer service, call 1-800-572-2797. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone) / 631.331.3664 (fax). Material for publication is welcomed— articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

ISSN 1931-6992

Mandatory Withdrawal of the Bankruptcy Reference in Brokerage Liquidations: *Madoff* and *MF Global*

EMIL A. KLEINHAUS

In decisions arising out of the Madoff and MF Global brokerage liquidations, district judges have concluded that Article III courts, rather than bankruptcy courts, should resolve significant issues under the Securities Investor Protection Act and the CFTC regulations governing commodity broker liquidations.

Under the federal statute that permits delegation of authority to bankruptcy courts, each district court "may provide that any or all cases under title 11 [the Bankruptcy Code] and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district."[1] The same statute, however, permits a district court to withdraw cases or proceedings from the bankruptcy court "for cause shown," and it *mandates* withdrawal of the reference when "resolution of the proceeding requires consideration of both [the Bankruptcy Code] and other laws of the United States regulating organizations or activities affecting interstate commerce."[2]

As demonstrated by the historic bankruptcies of Bernard L. Madoff Investment Securities and MF Global Inc., broker-dealer liquidations present

Emil A. Kleinhaus is a partner at Wachtell, Lipton, Rosen & Katz. The author's firm represented JPMorgan Chase in a motion to withdraw the reference in the *Madoff* proceeding, as well as ConocoPhillips in a motion to withdraw the reference in the *MF Global* proceeding. The author may be reached at eakleinhaus@wlrk.com.

Published by A.S. Pratt in the April/May 2013 issue of *Pratt's Journal of Bankruptcy Law*.

a special problem in defining the role of bankruptcy courts, because they are governed in large measure by "laws of the United States" *other than* the Bankruptcy Code. As registered broker-dealers, Madoff's firm and MF Global did not file voluntary cases under the Bankruptcy Code; rather, their liquidation proceedings resulted from lawsuits filed in district court by the Securities Investor Protection Corporation.[3] Under the Securities Investor Protection Act ("SIPA"), the proceedings were then referred to the bankruptcy court,[4] where they are governed both by SIPA and, "to the extent consistent with" SIPA, by the Bankruptcy Code.[5] In *MF Global*, moreover, the liquidation of the firm's commodity broker is governed by 17 C.F.R. Part 190, a set of regulations promulgated by the Commodity Futures Trading Commission to complement the subchapter of the Bankruptcy Code (Sections 761-767) that address commodity broker liquidations.[6]

In both *Madoff* and *MF Global*, customers and other parties moved to withdraw the reference in connection with disputes over the meaning and effect of SIPA or CFTC rules. Court-appointed trustees for the brokerage firms strongly resisted withdrawal, contending that SIPA and the CFTC Part 190 regulations — as laws that govern liquidation proceedings and interrelate with the Bankruptcy Code — fall within the domain of the bankruptcy court. As discussed below, the district courts have squarely rejected the trustees' position and have instead treated SIPA and the CFTC regulations as "other laws of the United States" for purposes of the mandatory withdrawal statute. The result in *Madoff* has been a large-scale shift in litigation of key issues to the district court; in *MF Global*, the result was a more limited removal of two notable disputes to the district court.

The withdrawal decisions in *Madoff* and *MF Global* are significant not only for brokerage liquidations. They suggest more broadly that, despite judicial reluctance to create an "escape hatch" from bankruptcy court, district courts will enforce the mandatory language of the withdrawal statute when the moving party identifies specific and serious issues of non-Bankruptcy Code federal law that require resolution, even if those issues may be familiar to bankruptcy courts or related to issues arising under the Bankruptcy Code.

MANDATORY WITHDRAWAL OF THE REFERENCE: OVERVIEW

Section 157 of Title 28, including subsection (d) governing withdrawal of the reference, was enacted into law as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984.[7] That amendment was largely a response to the decision of the United States Supreme Court in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, in which the Court held that under Article III of the Constitution, bankruptcy judges lacked the power to determine state-law damages actions brought by a bankruptcy estate against a party that had not filed a proof of claim.[8] In the 1984 amendment, Congress distinguished between "core" bankruptcy proceedings and "non-core" proceedings, and deprived bankruptcy courts of the power to enter final judgments in "non-core" proceedings.[9] In the first sentence of Section 157(d), Congress also provided district courts with the power to withdraw the reference from the bankruptcy court "for cause."[10]

The *mandatory* withdrawal language in the second sentence of Section 157(d), although enacted as part of the response to *Marathon*, is not focused on the Article III constraints at issue in that case. On its face, the statute requires withdrawal of the reference when resolution of a proceeding — whether "core" or "non-core" — requires "consideration" of both the Bankruptcy Code and "other laws of the United States" that regulate interstate commerce. One court has suggested, without pointing to specific legislative history,[11] that the mandatory language in Section 157(d) was a "reaction" not only to *Marathon* but also to the Supreme Court's decision in *National Labor Relations Board v. Bildisco and Bildisco*,[12] in which the Supreme Court considered both the Bankruptcy Code and the National Labor Relations Act in holding, among other things, that a debtor may reject a burdensome collective bargaining agreement if the "equities" support such rejection.[13] More broadly, courts have suggested that the statute reflects a congressional "perception that specialized [bankruptcy] courts should be limited in their control over matters outside their areas of expertise."[14]

The literal terms of the mandatory withdrawal statute are not easily applied. The statutory language is arguably over-inclusive insofar as it does not explicitly limit mandatory withdrawal to cases that raise substantial or even material issues involving "other laws of the United States."[15] At the same time, the statute is arguably under-inclusive insofar as it requires "consideration of *both* title 11 and other laws of the United States": this would appear to suggest that withdrawal is *not* required if a lawsuit raises non-bankruptcy issues but does not require "consideration" of the Bankruptcy Code.

The Second Circuit has addressed the difficulties presented by the statutory language by imposing a test: withdrawal of the reference is mandatory when a proceeding requires "significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statutes."[16] Another Second Circuit decision states, similarly, that withdrawal is mandatory when "substantial and material consideration of non-Bankruptcy Code federal statutes is necessary for resolution of the proceeding."[17] Under this test, "the district court is not required to find that novel or unsettled questions of non-bankruptcy law are presented in order to withdraw the reference."[18] However, "where matters of first impression are concerned, the burden of establishing a right to mandatory withdrawal is more easily met."[19] Likewise, the standard for mandatory withdrawal is met when a federal statute or regulation, including federal securities law, "'arguably conflicts' with the Bankruptcy Code."[20]

In sum, notwithstanding the statute's literal language, the Second Circuit and other courts: (1) do not require withdrawal of the reference for *any* "consideration" of non-Bankruptcy Code federal law — rather, such consideration has to be "significant" or "substantial"; and (2) do not limit withdrawal to cases requiring consideration of *both* the Bankruptcy Code and non-Bankruptcy Code federal law — rather, the need to address non-Bankruptcy Code federal law is sufficient. As discussed below, however, the courts have applied the withdrawal statute by its terms in distinguishing between "title 11" and "other laws of the United States," despite arguments that this distinction should be relaxed in situations where the "others laws" were enacted to govern liquidation proceedings.

WITHDRAWAL OF THE REFERENCE IN *MADOFF*

Application of the mandatory withdrawal statute has been the subject of intense litigation in the *Madoff* case. Beginning in 2009, the trustee for Bernard L. Madoff Investment Securities, Irving Picard, brought an array of lawsuits seeking to recoup losses suffered by customers. The lawsuits included both: (a) common law claims against financial institutions alleging that they aided and abetted Madoff's fraud; and (b) bankruptcy avoidance claims against "net winners" in the Ponzi scheme, "net losers" that the trustee alleges did not act in "good faith," and customers that withdrew funds within the 90-day preference period.[21] Defendants in both of these categories brought motions to withdraw the reference.

The *HSBC* and *JPMorgan* Actions

The first wave of motions to withdraw the reference in the *Madoff* case came in 2011, in suits brought by the trustee against various banks. Although each complaint is different, the core theory asserted by the trustee was that the bank defendants — including HSBC, Unicredit and JPMorgan — facilitated Madoff's scheme, and should be held liable for damages suffered by customers based on various common-law theories.

The defendants in the *HSBC* and *JPMorgan* actions brought motions to withdraw the reference on multiple grounds. For purposes of this article, their key argument was that SIPA does not confer standing on a trustee to bring damages claims on behalf of customers, and that significant interpretation of SIPA would be required to determine that issue of standing. In opposing withdrawal, the trustee contended that SIPA is effectively part of the "bankruptcy laws," and thus cannot provide a predicate for withdrawal, because SIPA explicitly incorporates aspects of the Bankruptcy Code and sets forth rules to govern liquidation proceedings.[22]

In two separate decisions, Judge Rakoff (in *HSBC*) and Judge McMahon (in *JPMorgan*) granted the motions to withdraw the reference.[23] The courts noted that federal bankruptcy law, independent of SIPA, does not confer standing on a trustee to bring damages claims on behalf of the estate's creditors. The trustee, accordingly, was necessarily relying on his status under SIPA in bringing suit — meaning that the court would have to engage in substantial analysis of SIPA to determine the trustee's standing or lack thereof. As explained by both judges, "while it is certainly true that SIPA liquidation proceedings may be brought in the bankruptcy court and that SIPA incorporates provisions of Title 11 to the extent that they are consistent with SIPA, 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)."[24]

Following withdrawal of the reference, the district courts in both *HSBC* and *JPMorgan* dismissed the trustee's common-law damages claims for lack of standing, and returned the remainder of the proceedings to the bankruptcy court.[25] As of this writing, the dismissal decisions are on appeal in the Second Circuit.

The *Katz* Action

Following on the heels of the motions to withdraw the reference in the *HSBC* and *JPMorgan* cases, the defendants in *Picard v. Katz* — best known as the owners of the New York Mets — brought a motion to withdraw the reference with respect to a lawsuit by the trustee seeking to recover approximately $1 billion in redemptions from Madoff's firm, including up to $300 million in excess of the defendants' initial investments. Notably, unlike the common-law claims at issue in *HSBC* and *JPMorgan*, the claims in *Katz* were exclusively avoidance claims brought under the Bankruptcy Code.[26]

The defendants argued that withdrawal of the reference was required to decide: (1) whether payments by Madoff's firm, including profits, were taken for "value" for purposes of Section 548(c) of the Bankruptcy Code because they satisfied antecedent debt under federal securities and state law; (2) whether payments by Madoff's firm, a broker-dealer subject to SIPA, are covered by the "safe harbor" in Section 546(e) of the Bankruptcy Code, which prohibits avoidance of "settlement payments" or transfers in connection with a "securities contract" (other than as intentional fraudulent transfers within a two-year period); and (3) whether customers of a securities broker have to defend their due diligence in order to sustain a "good faith" defense under Section 548(c) of the Bankruptcy Code.[27] In response, the trustee argued that all of those issues arose under the Bankruptcy Code and, moreover, had already been decided by the bankruptcy court adversely to the defendants.

The district court granted the motion to withdraw the reference. Although Judge Rakoff (who had accepted the *Katz* case as related to prior *Madoff* cases assigned to him) did not publish an opinion on the withdrawal motion, his ultimate ruling on the merits[28] provides insight into the basis for withdrawal of the reference.[29] In his decision on the merits, Judge Rakoff concluded, consistent with prior bankruptcy court decisions,[30] that the defendants did not take the transfers at issue for "value" to the extent they exceeded principal investments. However, contrary to decisions of the bankruptcy court,[31] Judge Rakoff also held that the "safe harbor" applicable to securities transactions applied as a matter of law to shield the transfers at issue from avoidance. Finally, Judge Rakoff held that the one claim that survived the "safe harbor" — the intentional fraudulent transfer claim under Section 548 of the Bankruptcy Code — would be subject to a broad "good faith" defense. In particular, Judge Rakoff concluded that, in the context of a SIPA proceeding, "where bankruptcy law is informed by federal securities law" and a "securities investor has no inherent duty to inquire about his stockbroker," defendants could show good faith by showing lack of scienter, *i.e.* actual knowledge or "willful blindness." This standard differs from the standard that has been applied in some bankruptcy cases, where lack of good faith has been equated with "inquiry notice" of fraud and inadequate due diligence.[32] By withdrawing the reference, therefore, Judge Rakoff was able to define the Bankruptcy Code's "good faith" defense in the context of a SIPA proceeding — an inquiry that, in the court's view, involved consideration of securities law in addition to bankruptcy law.

The withdrawal of the reference in *Katz*, along with the district court's decision on the merits, was a milestone in the *Madoff* liquidation. After *Katz* was decided, hundreds of additional motions to withdraw the reference were filed by defendants in avoidance proceedings. Judge Rakoff has largely granted such motions[33] and has, among other things: (a) reaffirmed that Madoff customers did not provide "value" for withdrawals above the amount of their principal investments;[34] and (b) concluded that Section 502(d) of the Bankruptcy Code, under which a creditor's claims against the estate are disallowed pending resolution of avoidance claims against the creditor, applies in SIPA proceedings.[35] A common theme in Judge Rakoff's decisions has been the need to consider the securities-law backdrop of a SIPA proceeding in adjudicating claims that arise under the Bankruptcy Code.

Stern v. Marshall Issues

Although not predicated on SIPA, the district court's withdrawal of the reference in *Madoff* to address issues arising from the Supreme Court's decision in *Stern* v. *Marshall*[36] is also noteworthy. In *Stern*, the Supreme Court held that Article III of the Constitution prevents a bankruptcy court from adjudicating claims involving "private rights," including affirmative claims brought by a debtor against a creditor that will not be completely resolved in the process of allowing or disallowing the creditor's proof of claim against the estate. Judge Rakoff, at the same time as he withdrew the reference to decide issues under SIPA, concluded that the application of *Stern* to fraudulent transfer claims required significant interpretation of "both Article III and the Supreme Court precedent analyzing it," and thus should be decided by an Article III Court.[37] Implicit in Judge Rakoff's ruling was the notion that, for purposes of the mandatory withdrawal statute, the United States Constitution should be treated as a "law of the United States regulating organizations or activities affecting interstate commerce."[38]

Following withdrawal of the reference on the *Stern* issue, Judge Rakoff concluded that fraudulent transfer claims, at least against non-creditors of the estate, are based on "private rather than public right" and thus have to be determined by a district court, despite Congress's denomination of such claims are "core" proceedings. The court also concluded, however, that bankruptcy courts could issue proposed findings and conclusions for review by the district court, and thus *declined* to withdraw the reference of the avoidance actions for "cause shown."[39] In sum, Judge Rakoff resolved the threshold non-bankruptcy question relating to the scope of the bankruptcy court's authority under Article III, but then referred the lawsuits to the bankruptcy court for further proceedings short of a final judgment.

WITHDRAWAL OF THE REFERENCE IN *MF GLOBAL*

The *MF Global* case has generated far less litigation than the *Madoff* case. Nonetheless, in two significant matters arising out of *MF Global* — namely, disputes between the trustee for MF Global and two former customers, ConocoPhillips and Koch — Judges Forrest and Buchwald of the Southern District of New York reaffirmed and expanded upon the reasoning of Judges Rakoff and McMahon in the *Madoff* case. In particular, the district courts in *MF Global* held that withdrawal of the reference was mandatory to resolve substantial issues raised by the CFTC regulations that govern commodity broker liquidations.[40] Both matters were subsequently settled before a decision on the merits.

ConocoPhillips and Koch were customers of MF Global that posted letters of credit, rather than cash or securities, as margin to secure commodity futures trading. ConocoPhillips procured $205 million in letters of credit for MF Global's benefit; Koch procured $10 million in letters of credit. Under the governing customer agreements, MF Global was entitled to draw upon the letters of credit only in the event of a default by the customer, but there was no allegation that ConocoPhillips or Koch had defaulted. In addition, the Koch letter of credit and some of the ConocoPhillips letters expired by their terms following the bankruptcy without being drawn.

In both *ConocoPhillips* and *Koch*, the trustee for MF Global — supported by the CFTC — took the position that despite the absence of a customer default followed by a draw on the letters of credit, the estate was entitled to retain the face value of the letters based on a CFTC regulation stating that "[t]he full proceeds of a letter of credit" are "customer property" in a brokerage liquidation.[41] According to the trustee, the CFTC regulation means that undrawn letters of credit posted as margin should be treated the same way as cash margin, *i.e.* as "customer property" subject to the claims process. Consistent with this position, the trustee concluded that ConocoPhillips and Koch had to file claims to recover the amounts of the undrawn letters of credit, including letters that had expired.

ConocoPhillips and Koch each brought motions to withdraw the reference.[42] Among other things, they argued that withdrawal was required to determine whether the trustee was correct in construing the term "full proceeds" in the CFTC regulation to include the face amount of undrawn letters of credit, including expired letters.[43] Echoing the *Madoff* trustee's argument about SIPA, the trustee in *MF Global* resisted withdrawal of the reference, arguing that the CFTC Part 190 regulations are "effectively part of title 11." The trustee emphasized that the CFTC regulations "implement" Sections 761 through 767 of Bankruptcy Code, which govern in commodity broker liquidations, and were expressly contemplated in the legislative history of the Bankruptcy Code. Unlike in *Madoff*, the trustee also claimed that the mandatory withdrawal may not apply at all to proceedings referred to the bankruptcy court under SIPA, because 11 U.S.C. § 157(d) on its face only authorizes withdrawal of proceedings "referred under this section," *i.e.* 11 U.S.C. § 157(a).

Both district courts withdrew the reference. Despite the "close connection" between the CFTC Part 190 regulations and the Bankruptcy Code, Judge Forrest observed that the regulations are not part of the Bankruptcy Code and, moreover, "were promulgated pursuant to powers granted to the CFTC under the [Commodity Exchange Act], which indisputably is not part of title 11."[44] Judge Buchwald noted that the relevant provision of the Commodity Exchange Act, 7 U.S.C. § 24(a)(1), expressly permits the CFTC to vary the Bankruptcy Code's definition of "customer property," further evidencing that the regulations are distinct from the Bankruptcy Code.[45]

Judge Forrest also took pains to address the trustee's argument that withdrawal of the reference would require "vast numbers of questions" in commodity liquidations to "go to the district courts." While acknowledging the Second Circuit's direction that the withdrawal statute should be "construed narrowly," Judge Forrest concluded that withdrawal as to the particular issue presented was appropriate, because that issue required "substantial and material consideration" of non-title 11 law and raised a "larger question" relating to the treatment of letters of credit both "in and out of liquidation."[46]

Neither judge explicitly addressed the trustee's argument that 11 U.S.C. § 157(d) only applies to proceedings referred to bankruptcy court under 11 U.S.C. § 157(a), and not to proceedings referred under SIPA. The argument has several weaknesses. First, although the first sentence of Section 157(d) states that a "case or proceeding referred under this section" may be withdrawn "for cause," the *second* sentence, which governs mandatory withdrawal, does not repeat or incorporate the "this section" requirement of the first sentence. Second, and more decisively, SIPA on its face requires that a SIPA proceeding "be conducted in accordance with, and as though it were being conducted under…title 11," strongly indicating that withdrawal of the reference is available in SIPA proceedings as in ordinary bankruptcies.[47]

COMMENT

The withdrawal decisions in *Madoff* and *MF Global*, although arising out of extraordinary situations, offer several lessons for future cases.

On a narrow level, the decisions show that district courts, at least in New York, will not carve out SIPA, CFTC regulations or other non-title 11 laws from the mandatory withdrawal statute simply because they apply in liquidation proceedings and complement the Bankruptcy Code. Rather, consistent with the language of Section 157(d), the courts have drawn a simple distinction between “title 11” and “other laws of the United States,” even when the “other laws” are focused on liquidations that occur in bankruptcy court. As a result, it is quite possible, if not probable, that district courts will continue to play a relatively active role in brokerage liquidations, including in deciding “hybrid” issues that involve both the Bankruptcy Code and others laws such as SIPA and CFTC rules.

More broadly, the *Madoff* and *MF Global* decisions reaffirm that, in any context, the mandatory withdrawal statute can be a powerful tool when used properly. In *Madoff* and *MF Global*, the moving parties identified dispositive legal issues arising under federal laws other than the Bankruptcy Code. In doing so, the movants persuaded the district courts not only that non-bankruptcy issues were presented, but also that withdrawal of the reference could not be deferred. A clear lesson from the cases is that mandatory withdrawal motions are most likely to be successful when district courts are given the opportunity to decide discrete legal issues or claims without interfering more broadly with the ongoing bankruptcy process.

Finally, the *Madoff* case in particular highlights the importance, especially for trustees, of pursuing related actions in a coordinated way. Although Judge Rakoff has sought to maximize efficiency in *Madoff* by accepting new withdrawal motions as “related” and deciding issues in tandem across many actions, not all defendants have sought to withdraw the reference — and, as discussed above, the bankruptcy court and the district court have reached inconsistent results on at least one major issue (the safe harbor). Thus, pending a decision by the Second Circuit, different adversary proceedings within the same liquidation are currently subject to different rules, creating an obstacle to settlement and a recipe for delay. It is unclear whether the trustee could have taken steps to avoid this result, such as consolidating major avoidance actions for pre-trial motions. In any event, in future cases, it can be expected that trustees and other parties will take into account the possibility of successful withdrawal motions in crafting litigation strategies and coordinating among actions that raise related issues.

NOTES

[1] 28 U.S.C. § 157(a). "Title 11" refers to title 11 of the United States Code.

[2] 28 U.S.C. § 157(d).

[3] *Securities Investor Protection Corp. v. MF Global Inc.*, Case No. 11-CV-7750 (S.D.N.Y. Oct. 31, 2011); *Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities LLC*, 08-cv-10791 (S.D.N.Y. Dec. 15, 2008).

[4] 15 U.S.C. § 78eee(b)(4).

[5] 15 U.S.C. § 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 chapters 1, 3, and 5 and subchapters I and II of chapter 7 of title 11.").

[6] 7 U.S.C. § 24 (granting authority to promulgate rules).

[7] *See* E-1 Collier on Bankruptcy App. Pt. 6-12 (16th ed.); Pub. L. No. 98-353.

[8] 458 U.S. 50, 71-72 (1982) (plurality opinion). For a discussion of the legislative response to *Marathon*, including the enactment of Section 157(d), see, for example *Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1100 (2d Cir. 1993).

[9] 28 U.S.C. § 157(b)(1); 28 U.S.C. § 157(c)(1).

[10] Under Second Circuit law, a primary question in determining whether to withdraw the reference "for cause" is whether a bankruptcy court has the power to adjudicate the claims in that proceeding. *Orion Pictures Corp.*, 4 F.3d at 1101; *accord, e.g.*, *Lehman Bros. Holdings Inc. v. JPMorgan Chase Bank, N.A. (In re Lehman Bros. Holdings Inc.)*, 480 B.R. 179, 188-89 (S.D.N.Y. 2012).

[11] *In re White Motor Corp.*, 42 B.R. 693, 701 (N.D. Ohio 1984). In a separate discussion, the court undertook a detailed overview of Section 157's legislative history. 42 B.R. at 697-700. While there were statements from legislators to the effect that the language should not be an "escape hatch" and should be "construed narrowly," the legislative history is not otherwise informative.

[12] 465 U.S. 513 (1984).

[13] Following *Bildisco*, as part of the 1984 amendments, Congress enacted Section 1113 of the Bankruptcy Code, which sets forth stringent rules for rejection of collective bargaining agreements. *See, e.g.*, *In re AMR Corp.*, 477 B.R. 384, 405-06 (Bankr. S.D.N.Y. 2012).

[14] *AT&T Co. v. Chateaugay Corp.*, 88 B.R. 581, 583-84 (S.D.N.Y. 1988); *accord In re Horizon Air, Inc.*, 156 B.R. 369, 374 n.5 (N.D.N.Y. 1993).

[15] *See, e.g.*, *Houbigant, Inc. v. ACB Mercantile, Inc. (In re Houbigant, Inc.)*, 185

B.R. 680, 683 (S.D.N.Y. 1995) (noting that a literal application of the statute would "eviscerate much of the work of the bankruptcy courts").

[16] *City of New York v. Exxon Corp.*, 932 F.2d 1020, 1026 (2d Cir. 1991) (discussing withdrawal of the reference to interpret CERCLA).

[17] *Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 995 (2d Cir. 1990); *accord, e.g. Chemtura Corp. v. United States*, 2010 WL 1379752, at *1 (S.D.N.Y. Mar. 26, 2010) (quoting *Shugrue*, 922 F.2d at 995) (internal quotation marks omitted); *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).

[18] *Enron Corp. v. J.P. Morgan Sec., Inc.* (*In re Enron Corp.*), 388 B.R. 131, 139 (S.D.N.Y. 2008); *accord Enron Power Mktg.*, 2004 WL 2711101, at *2.

[19] *Bear, Stearns Sec. Corp. v. Gredd*, 2001 WL 840187, at *2 (S.D.N.Y. July 25, 2001) (internal quotation marks omitted).

[20] *In re Dana Corp.*, 379 B.R. 449, 459 (S.D.N.Y. 2007) (quoting *Bear, Stearns Sec. Corp. v. Gredd*, 2001 WL 840187, at *2 (S.D.N.Y. July 25, 2001)).

[21] The trustee's lawsuits are summarized in each of the interim reports filed by the trustee, which are publicly available at www.madofftrustee.com.

[22] Prior to *Madoff*, courts had applied the mandatory withdrawal statute in SIPA liquidations to address issues of federal non-bankruptcy law, but not issues arising under SIPA itself. *See, e.g.*, *Mishkin v. Ageloff,* 220 B.R. 784, 795-98 (S.D.N.Y. 1998) (withdrawal to consider issues under the Private Securities Litigation Reform Act).

[23] *Picard v. JPMorgan Chase & Co.*, 454 B.R. 307 (S.D.N.Y. 2011); *Picard v. HSBC Bank PLC*, 450 B.R. 406 (S.D.N.Y. 2011).

[24] *HSBC*, 450 B.R. at 410; *accord JPMorgan*, 454 B.R. at 316.

[25] *Picard v. JPMorgan Chase & Co.*, 460 B.R. 84 (S.D.N.Y. 2011); *Picard v. HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011).

[26] Based on Section 548 of the Bankruptcy Code, the trustee brought intentional and constructive fraudulent transfer claims to recover withdrawals made within two years of the bankruptcy. Based on Section 544(b), which permits a trustee to bring state-law avoidance claims of creditors, the trustee brought claims under New York law to recover withdrawals within six years. The trustee also brought claims under Section 547 of the Code seeking to recover withdrawals made within 90 days of the bankruptcy filing. *See Picard v. Katz*, Adv. Pro. No. 10-05287 (Bankr. S.D.N.Y. Feb. 3, 2011).

[27] Under Section 548(c) of the Bankruptcy Code, a transferee may retain a fraudulent transfer to the extent it "takes for value and in good faith." 11 U.S.C.

§ 548(c). The trustee claimed that the defendants did not give "value" for the profits they received and did not take either profits or principal in "good faith."

[28] *Picard v. Katz*, 462 B.R. 447 (2011), *amended by* 466 B.R. 208 (S.D.N.Y. 2012).

[29] Judge Rakoff made some comments on the record explaining his grounds for withdrawal, stating, among other things, that it was not "self-evident at all that the bankruptcy law sets the parameters of the duty of inquiry that a customer in a securities brokerage investment situation has," and that the movants had plausibly argued that "the duty of inquiry of their clients in a securities context is governed by securities law." *Picard v. Katz*, 11-CV-3605 (S.D.N.Y. July 1, 2011), Docket No. 33, at 32-34.

[30] The bankruptcy court had previously concluded that customers, including the *Katz* defendants, had valid claims only for their net losses, and not for amounts reflected on falsified account statements. *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122, 135-37, 139-42 (Bankr. S.D.N.Y. 2010). The bankruptcy court had also concluded that "when investors invest in a Ponzi scheme, any payments that exceed their principal investments are not made for reasonably equivalent value and can be recovered by the trustee as fraudulent conveyances." *Picard v. Chais*, 445 B.R. 206, 227 (Bankr. S.D.N.Y. 2011).

[31] The bankruptcy court had held that the applicability of the "safe harbor" could not be determined as a matter of law, and that applying the safe harbor would conflict with SIPA's remedial purposes. *Picard v. Merkin*, 440 B.R. 243, 266-68 (Bankr. S.D.N.Y. 2010), *lv. to appeal denied*, 2011 WL 3897970 (S.D.N.Y. 2011); *see also Picard v. Madoff*, 458 B.R. 87, 115-16 (Bankr. S.D.N.Y. 2011) (concluding, in a lawsuit against Madoff family members, that the "safe harbor" was not a basis for dismissal of avoidance claims).

[32] *Katz*, 462 B.R. at 454-55 (citing *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 22-23 (S.D.N.Y. 2007)).

[33] *See, e.g.*, *Picard v. Avellino*, 469 B.R. 408 (S.D.N.Y. 2012); *Picard v. Flinn Investments, LLC*, 463 B.R. 280 (S.D.N.Y. 2011).

[34] *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 476 B.R. 715 (S.D.N.Y. 2012).

[35] *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC*, No. 12 –MC- 115 (S.D.N.Y. Feb. 12, 2013).

[36] 131 S. Ct. 2594 (2011).

[37] *E.g.*, *Picard v. Flinn Inv.*, 463 B.R. at 287-88.

[38] There is a division of authority as to whether constitutional questions are

subject to mandatory withdrawal. *Compare, e.g.*, *In re Chateaugay Corp.*, 108 B.R. 27 (S.D.N.Y. 1989) (withdrawal of the reference to interpret "constitutional provisions"), *with, e.g.*, *In re Roman Catholic Bishop of San Diego*, 2007 WL 2406899, at *3 (S.D. Cal. Aug. 20, 2007) (denying withdrawal motion: "If Congress intended all actions involving constitutional issues to be subject to mandatory withdrawal, it could have so provided.").

[39] *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC*, -- B.R. --, 2013 WL 67605 (S.D.N.Y. Jan. 4, 2013).

[40] *Koch Supply & Trading LP v. Giddens* (*In re MF Global Inc.)*, 484 B.R. 18 (S.D.N.Y. 2012); *ConocoPhillips Co. v. Giddens* (*In re MF Global, Inc.*), No. 12 Civ. 6014, 2012 WL 4757866 (S.D.N.Y. Oct. 4, 2012).

[41] 17 C.F.R. § 190.08(a)(1)(i)(E).

[42] The briefing on the motions to withdraw the reference, as well as merits briefing, is available at http://www.cftc.gov/IndustryOversight/Intermediaries/mfglobal.

[43] *See* 7 U.S.C. § 27a(a)(1); see 15 U.S.C. § 78c note.

[44] *ConocoPhillips*, 2012 WL 4757866, at *5 & n.7; *accord Koch*, 484 B.R. at 23.

[45] *Koch*, 484 B.R. at 23.

[46] *ConocoPhillips*, 2012 WL 4757866, at *5.

[47] 15 U.S.C. § 78fff(b); *see Barton v. SIPC*, 185 B.R. 701, 703 (D.N.J. 1994) ("Since SIPA proceedings are treated like bankruptcy proceedings, in an appropriate case they c[an] be withdrawn to the district court.").