No. 19-277

IN THE

Supreme Court of the United States

HSBC HOLDINGS PLC, *et al.*,

Petitioners,

v.

IRVING H. PICARD AND
SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF IN OPPOSITION FOR RESPONDENT SECURITIES INVESTOR PROTECTION CORPORATION

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QUESTIONS PRESENTED

1. Whether the Second Circuit correctly held that applying 11 U.S.C. § 550(a)(2) of the Bankruptcy Code to permit the recovery of property initially fraudulently transferred by a U.S. debtor from a U.S. bank account was a domestic application of the statute even where the property was subsequently transferred between foreign parties.

2. Whether the Second Circuit correctly held that a bankruptcy court's and district court's holdings that concerns of prescriptive comity precluded the application of United States law should be reviewed *de novo*.

PARTIES TO THE PROCEEDING

Petitioners are listed in the appendix to the petition. Pet. App. 185a–266a.

Respondents are (i) Irving H. Picard, as Trustee for the liquidation of Bernard L. Madoff Investment Securities LLC, and (ii) the Securities Investor Protection Corporation (SIPC). SIPC is a party in interest as to all matters arising in a liquidation proceeding under the Securities Investor Protection Act, "with the right to be heard on all such matters, and shall be deemed to have intervened with respect to all such matters with the same force and effect as if a petition for such purpose had been allowed by the court." 15 U.S.C. § 78eee(d). SIPC intervened and fully participated in the argument before the Second Circuit. See Pet. App. 3a. Accordingly, though omitted from the caption, SIPC is considered a respondent, Sup. Ct. R. 12.6, as acknowledged on page ii of the petition.

CORPORATION DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Supreme Court Rules, the Securities Investor Protection Corporation certifies that it has no parent corporation and there is no publicly held corporation owning 10% or more of stock in the Securities Investor Protection Corporation.

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BRIEF IN OPPOSITION FOR RESPONDENT SECURITIES INVESTOR PROTECTION CORPORATION

COUNTERSTATEMENT OF THE CASE

This petition arises from the liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS") under the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa–78*lll* ("SIPA").[1] SIPA, which created the Securities Investor Protection Corporation ("SIPC"),[2] provides protection to customers of SIPC member firms that fail financially and must be liquidated.

In a SIPA liquidation proceeding, the SIPA trustee is obligated to marshal customer property, wherever located, and promptly return such property to customers. When there is a shortfall in customer property, SIPA empowers the trustee to recover any property transferred by the debtor firm. Customers of the debtor enjoy priority claims to the fund of customer property marshaled by the trustee – a reflection of SIPC members' obligation to segregate customer property under the Securities Exchange Act rules and regulations. 17 C.F.R. § 240.15c3-3. Furthermore, to expedite the return of customer

[1] For convenience, future references to SIPA shall omit "15 U.S.C."

[2] "SIPC shall be deemed to be a party in interest as to all matters arising in a liquidation proceeding, with the right to be heard on all such matters . . . ." SIPA § 78eee(d).

property and to restore missing property, customers may receive an advance of up to $500,000 from SIPC.

1. As is well known, through BLMIS, a New York broker-dealer, Bernard L. Madoff ("Madoff") orchestrated the largest Ponzi scheme in history. Pet. App. 7a. Madoff enticed customers to invest funds in their BLMIS securities accounts by offering unusually high and consistent returns. *Id.* Madoff, however, never invested customers' funds in the securities markets, but rather commingled them in an account held by BLMIS at JPMorgan Chase in New York (the "N.Y. Chase Account"). *Id.* Madoff's supposed returns were, in fact, fictitious, fabricated by Madoff by concocting supposed profitable trades and securities positions after the fact. Any withdrawals provided to BLMIS investors necessarily came from commingled funds in the N.Y. Chase Account – in other words, funds stolen from other customers. *Id.*

A significant source of new investments in Madoff's Ponzi scheme flowed through "feeder funds" organized in foreign jurisdictions. Pet. App. 9a. These feeder funds pooled funds from other investors – primarily foreign investors, including the Petitioners – for deposit in the feeder fund's BLMIS account in New York. *Id.* When a feeder fund investor wished to redeem an investment, the feeder fund requested a withdrawal from BLMIS. Pet. App. 10a. Madoff then transferred funds from the commingled customer property held in the N.Y. Chase Account to the foreign feeder fund, which subsequently transferred the funds to the investor. Pet. App. 10a–11a.

2. Although unusually long running, Madoff's Ponzi scheme suffered the same fate as other Ponzi schemes: when withdrawals outpaced deposits, the scheme collapsed, resulting in Madoff's arrest on December 11, 2008. On December 15, 2008, upon an application by SIPC, BLMIS was placed into liquidation under SIPA, and Irving H. Picard was appointed as trustee (the "Trustee"). Pet. App. 7a–8a. As a result of BLMIS's collapse, many of the feeder funds, having heavily invested through BLMIS, failed as well and had to be liquidated in separate proceedings. Pet. App. 10a–11a.

Facing a shortfall of approximately $20 billion of customer property that was supposed to be held by BLMIS, the Trustee, utilizing his powers under SIPA, brought numerous actions to avoid withdrawals from the Ponzi scheme as actual fraudulent transfers under the Bankruptcy Code, 11 U.S.C. § 548(a)(1)(A).[3] To the extent that a transfer is avoided, the Trustee may recover the property transferred from either the initial transferee, § 550(a)(1), or a subsequent transferee, § 550(a)(2). At issue here are the Trustee's actions under Bankruptcy Code § 550(a)(2) to recover customer property fraudulently transferred by BLMIS to the feeder funds and now held by the Petitioners – foreign feeder fund investors who subsequently

[3] For convenience, future references to the Bankruptcy Code shall omit "11 U.S.C." To the extent consistent with SIPA, a liquidation proceeding is governed by chapters 1, 3, and 5, and subchapters I and II of chapter 7, of the Bankruptcy Code. SIPA § 78fff(b). A SIPA trustee also has additional powers and duties specified in SIPA § 78fff-1.

received the property from the feeder funds. Pet. App. 11a.

On a motion to dismiss by one defendant, the United States Bankruptcy Court for the Southern District of New York (Lifland, J.) held that the presumption against extraterritoriality did not bar the Trustee's recovery action, holding both that the Trustee's application of § 550(a) was domestic and, alternatively, that § 550(a) may be applied extraterritorially. *See Picard* v. *Bureau of Labor Ins.*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012) ("*BLI*").

Separate from *BLI*, however, the United States District Court for the Southern District of New York withdrew the reference to the bankruptcy court on the other actions below in order to address this same issue: whether the Trustee could recover, under § 550(a)(2), customer property subsequently transferred from a foreign feeder fund to a foreign investor. Pet. App. 164a. Without addressing *BLI*, the district court held that he could not. First, the district court, applying the two-prong approach implemented in *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010), held that the actions were barred by the presumption against extraterritoriality because: (i) § 550(a)(2) focused on the subsequent transfer itself and thus demanded extraterritorial application in these cases; and, (ii) the statute did not indicate that it had extraterritorial reach. Pet. App. 165a–177a. Second, the district court held that, independent of the presumption against extraterritoriality, the actions were barred by concerns of international comity, in deference to the liquidation of certain feeder funds in their respective jurisdictions. Pet. App. 177a–179a. The district

court returned the actions to the bankruptcy court for rulings on the Petitioners' motions to dismiss consistent with the district court's decision. Pet. App. 180a.

On remand, the bankruptcy court dismissed, on international comity grounds, those actions brought by the Trustee against Petitioners who had invested in feeder funds that had been placed into liquidation. Pet. App. 82a–89a. Deeming the location of the ultimate transfer to be the critical factor in determining the focus of § 550(a), the bankruptcy court further held that the presumption against extraterritoriality, as articulated by the district court, barred the actions against the remaining Petitioners whose transfers occurred abroad. Pet. App. 113a–152a. The Trustee appealed.

The United States Court of Appeals for the Second Circuit reversed. First, it held that Bankruptcy Code § 550(a) focused on the *initial* transfer that depleted the debtor's estate rather than on any subsequent transfers. Pet. App. 21a–22a. Actions to recover property fraudulently transferred by BLMIS – transfers by a U.S. debtor from a U.S. bank – applied § 550(a) to a domestic issue and did not implicate the presumption against extraterritoriality.[4] Pet. App. 25a–26a.

Second, distinguishing between a court's decision to abstain from a case under adjudicative comity and

[4] The Second Circuit thus did not reach the question of whether Bankruptcy Code § 550(a) has an extraterritorial reach. Pet. App. 27a.

a court's choice-of-law analysis under prescriptive comity, the Second Circuit found that the lower courts' comity decisions rested upon prescriptive comity. Pet. App. 21a. Reviewing such statutory interpretation issues *de novo*, the Second Circuit held that the United States has a compelling interest in the recovery of fraudulently transferred property by domestic debtors, and that this interest outweighs the interests of foreign jurisdictions liquidating the initial transferee feeder funds. Pet. App. 35a–37a. Prescriptive comity thus did not bar the Trustee's actions.

This Petition followed.

REASONS FOR DENYING THE PETITION

The Petition should be denied because the Second Circuit was correct in holding that a domestic debtor's fraudulent transfer of property from the United States is domestic activity for purposes of the Bankruptcy Code. The Second Circuit did not rely upon SIPA in reaching its conclusion. Pet. App. 24a, n.8. However, as these cases arise within the context of a SIPA liquidation proceeding, SIPC submits that application of SIPA provides additional reasons to deny the Petition. Under SIPA, the fraudulent transfer of property – to any jurisdiction – from a U.S. SIPC member broker-dealer reduces the fund of customer property available to recompense customers, and thus implicates substantial U.S. interests in protecting U.S. securities markets.

I. The Decision of the Second Circuit Is Correct for the Additional Reason That, in a SIPA Liquidation Proceeding, the Focus of a Recovery Action Is on the Return of Customer Property Entrusted to a Domestic Brokerage Firm

1. As this Court has held, under the presumption against extraterritoriality, "[a]bsent clearly expressed congressional intent to the contrary, federal laws will be construed to have only domestic application." *RJR Nabisco, Inc. v. European Cmty.*, 136 S. Ct. 2090, 2100 (2016). The Court has crafted a "two-step framework," *id.* at 2101 & n.5, for analyzing the presumption within a particular case: (1) whether the statute indicates an extraterritorial reach and, if not, (2) whether this case involves a domestic application of the statute. *Id.* at 2101. Where appropriate, these steps may be taken in either order; logically, if a statute's application is clearly domestic, it does not matter whether the statute may be permissibly applied extraterritorially. *See id.* at 2101 n.5.

Importantly for purposes of this case, a statute's focus determines whether its application is domestic or extraterritorial: "If the conduct relevant to the statute's focus occurred in the United States, then the case involves a permissible domestic application even if other conduct occurred abroad." *Id.* at 2101. As the Court recently explained, "[t]he focus of a statute is the 'object of its solicitude,' which can include the conduct it 'seeks to "regulate"' as well as the parties and interests it 'seeks to "protect"' or vindicate." *WesternGeco LLC v. ION Geophysical Corp.*, 138 S. Ct. 2129, 2137 (2018) (quoting

Morrison, 561 U.S. at 267) (original brackets omitted)). The focus of a statute is not analyzed in a vacuum but must be considered within the statutory scheme, as it is actually applied. *Id.*

In the decision below, the Second Circuit engaged in a thorough analysis of Bankruptcy Code § 550(a). Holding that the Code's recovery provision, § 550(a), works in tandem with the avoidance provision, § 548(a)(1)(A), the court looked to § 548(a)(1)(A)'s purpose in order to ascertain § 550(a)'s focus. Pet. App. 19a–22a. Together, Bankruptcy Code § 548(a)(1)(A) and § 550(a) regulate and remedy the debtor's fraudulent transfer of property and thus focus on the initial transfer of property. Pet. App. 20a. Here, that transfer is the fraudulent transfer by BLMIS, a U.S. debtor, from its N.Y. Chase Account, to the detriment of BLMIS's customers and creditors. Pet. App. 25a. Thus, the Second Circuit properly held that the Trustee's use of § 550(a) to recover property that had been first transferred from the N.Y. Chase Account, and ultimately to a foreign entity, was a domestic application of the statute. Pet. App. 27a.

2. SIPA provides further support for this conclusion, rendering the Petition without merit. In this SIPA liquidation proceeding, the transfer by BLMIS of customer funds through its N.Y. Chase Account was clearly a domestic transaction, thus implicating SIPA's goal of protecting investors in U.S. broker-dealers that comprise SIPC's membership.

Congress enacted SIPA in 1970 to address a worsening crisis in the U.S. securities industry. *Sec.*

Inv'r Prot. Corp. v. Barbour, 421 U.S. 412, 415 (1975). The industry faced a period of contraction which led to the "failure or instability of a significant number of brokerage firms." *Id.* Investor confidence suffered as customer assets were tied up and dissipated in lengthy liquidation proceedings, threatening open transactions and the viability of other brokerage firms. *Id.* "Congress enacted the SIPA to arrest this process, restore investor confidence in the capital markets, and upgrade the financial responsibility requirements for registered broker and dealers." *Id.* The upgraded financial responsibility requirements include Securities Exchange Act Rule 15c3-3, 17 C.F.R. § 240.15c3-3, known as the Customer Protection Rule. The Customer Protection Rule requires U.S.-registered broker-dealers (1) to take and maintain possession and control of fully paid and excess margin securities entrusted by customers to the firm, and (2) to maintain a special reserve bank account for the exclusive benefit of customers. *Id.*[5]

Essential to its goal of mitigating broker-dealer failures, SIPA also created SIPC, a non-profit membership corporation, and mandated that, with narrow exceptions, broker-dealers registered with the U.S. Securities and Exchange Commission are SIPC members. SIPA § 78ccc(a). The Customer Protection Rule governs a broker-dealer's operations;

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[5] *See also* Michael P. Jamroz, *The Customer Protection Rule*, 57 Bus. Law. 1069, 1070 (May 2002) ("The [Customer Protection Rule], which can be loosely described as a 'segregation rule,' divides the customer and proprietary activities of the firm.").

SIPC steps in when a broker-dealer's failure threatens customers. When a SIPC member is in or approaching financial difficulty – including a failure to abide by the Customer Protection Rule – and cannot meet its obligations to customers, SIPC may file an application to commence a liquidation proceeding for the protection of customers. To this end, "[SIPA] creates a new form of liquidation proceeding, applicable only to member firms, designed to accomplish the completion of open transactions and the speedy return of most customer property." *Barbour*, 421 U.S. at 416.

A SIPA liquidation proceeding thus focuses upon protecting and fulfilling a U.S. brokerage firm's obligations to its customers, thereby providing stability to the U.S. securities industry. The SIPA liquidation proceeding prioritizes claims to "customer property," defined in terms of property entrusted to the domestic debtor: "cash and securities . . . at any time received, acquired, or held by or for the account of a debtor from or for the securities accounts of a customer, and the proceedings of any such property transferred by the debtor, including property unlawfully converted." SIPA § 78*lll*(4). Mirroring the priorities in U.S. securities regulations as enacted in the Customer Protection Rule, customer property is segregated to satisfy the claims of customers. SIPA § 78fff-2(c)(1). Customers share ratably in the fund of customer property to the extent of their "net equity," essentially the amount owed to them by the broker-dealer minus any indebtedness to the broker-dealer. SIPA §§ 78fff-2(b); 78*lll*(11). After receiving a customer claim, the SIPA trustee "shall promptly discharge . . .

all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash . . . ." SIPA § 78fff-2(b).

And just as the satisfaction of customer claims in a SIPA liquidation proceeding has a domestic focus on the customer property entrusted to, and related obligations of, a domestic broker-dealer, so too does the SIPA trustee's ability to recover fraudulent transfers of customer property. Indeed, these two trustee functions – satisfaction of customer claims and recovery of customer property – are expressly linked:

> Whenever customer property is not sufficient to pay in full the claims [to customer property], the 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.

SIPA § 78fff-2(c)(3). This provision provides that whether or not the property sought by a SIPA trustee qualifies as property of the debtor under state law, such customer property shall be treated as property of the debtor for the purpose of the trustee's recovery action. *Id.*; *see also Picard v. Fairfield Greenwich Ltd.*, 762 F.3d 199, 213 (2d Cir. 2014) (stating that SIPA creates a "legal fiction that confers standing on a SIPA trustee by treating customer property as though it were 'property of the debtor' in an ordinary liquidation"). Any "recovered property shall be treated as customer property" for

distribution in satisfaction of the debtor's customer obligations. SIPA § 78fff-2(c)(3).

Recovery in a SIPA liquidation proceeding is premised upon both (i) voidability of the debtor's transfer of property and (ii) the debtor's failure to segregate customer property sufficient to satisfy its obligations. SIPA and the securities regulations – particularly the Customer Protection Rule – are built on the core concept that the customer property entrusted to, and in the custody of, U.S. registered broker-dealers must remain segregated and protected for the benefit of securities investors.

Importantly for purposes of this case, Congress did not limit the reach of SIPA's provisions governing the recovery of property to only property located in the United States. As this Court has recognized, "[t]he mere filing of an SIPC application gives the court in which it is filed exclusive jurisdiction over the member and its property, *wherever located*," *Barbour*, 421 U.S. at 416 (emphasis added), "including property located outside the territorial limits of such court . . . ." SIPA § 78eee(b)(2)(A)(i).

This is the "'object of the statute's solicitude,'" and avoidance and recovery of fraudulent transfers of customer property are "the means by which the statute achieves its end . . . ." *WesternGeco*, 138 S. Ct. at 2138 (quoting *Morrison*, 561 U.S. at 267) (brackets omitted). In other words, SIPA § 78fff-2(c)(3), working in tandem with the Bankruptcy Code avoidance and recovery provisions, "seeks to regulate" transfers of customer property by the domestic debtor which dissipate the pool of customer property, thereby "'seek[ing] to protect' or

vindicate" the rights of participants in the U.S. securities markets. *WesternGeco*, 138 S. Ct. at 2137 (quoting *Morrison* 561 U.S. at 267) (original brackets omitted).

In this case, a ruling upholding the decisions of the bankruptcy and district courts would create a roadmap for fraud. Any bad actor at a SIPC member firm would be able to convert or launder money simply by sending it to a foreign jurisdiction and then arranging a subsequent transfer to another foreign entity. *See* Pet. App. 26a–27a. Recipients of the funds would get to treat property that belonged to customers of a U.S. broker-dealer as their own. Such a result would directly contravene SIPA, which gives U.S. courts jurisdiction over the debtor's property "*wherever located*." SIPA § 78eee(b)(2)(A)(i) (emphasis added).

Thus, while the Second Circuit reached the correct conclusion in this case, application of SIPA to the facts here provides additional support for that conclusion, and reveals why this case presents a poor vehicle to review the first question presented.

II. The Decision of the Second Circuit Is Correct for the Additional Reason That, Regardless of the Standard of Review, the Lower Courts' Erroneous Legal Analysis of Prescriptive Comity Warranted Reversal by the Second Circuit

The parties do not dispute that, of the distinct doctrines of international comity – including prescriptive and adjudicative – only prescriptive comity might apply in this case. Under prescriptive

comity, courts should "construe[ ] ambiguous statutes to avoid unreasonable interference with the sovereign authority of other nations." *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 164 (2004). The Second Circuit held that issues of prescriptive comity present questions of statutory interpretation, which the court reviews *de novo*. Pet. App. 29a. The Second Circuit recognized, however, that "'[i]n review of decisions to abstain, there is little practical distinction between review for abuse of discretion and review *de novo*.'" Pet. App. 30a (quoting *Royal & Sun All. Ins. Co. of Canada v. Century Int'l Arms, Inc.*, 466 F.3d 88, 92 (2d Cir. 2006)).

As explained in the Trustee's Brief in Opposition to the Petition, the premise of the Petitioners' second question presented is wrong. When properly accounting for the distinction between prescriptive comity and adjudicative comity, there is no conflict between the circuits regarding the appropriate standard of review. Even if the Second Circuit had reviewed the lower courts' decisions for abuse of discretion, the result would not change. The lower courts do not have discretion to refuse jurisdiction on the basis of an erroneous legal analysis.

"Jurisdiction existing, . . . a federal court's 'obligation' to hear and decide a case is 'virtually unflagging.'" *Sprint Commc'ns, Inc. v. Jacobs*, 571 U.S. 69, 77 (2013) (quoting *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 817 (1976)). In declining to exercise jurisdiction over a case involving significant U.S. interests in favor of the interests of foreign jurisdictions, the district and bankruptcy courts misinterpreted the relevant

statutory provisions, committing legal error which is reversible under either *de novo* or abuse-of-discretion review. A trial court "necessarily abuse[s] its discretion if it base[s] its ruling on an erroneous view of the law." *Highmark Inc. v. Allcare Health Mgmt. Sys., Inc.*, 572 U.S. 559, 563 n.2 (2014).

Centrally, the district court and bankruptcy court erred in their comity analysis by focusing the inquiry under § 550(a)(2) upon the subsequent transfer, rather than the conduct which the statute seeks to regulate – the fraudulent transfer of customer property by a U.S. broker-dealer out of a bank account in New York. This misdirected focus in turn led the lower courts to conclude that "[t]he United States has no interest in regulating the relationship between the [feeder funds] and their investors," Pet. App. 81a, and that "investors in these foreign funds had no reason to expect that U.S. law would apply to their relationship with the feeder funds." *Id.* at 178a–179a. By focusing on the foreign transfer rather than the domestic interests under the Bankruptcy Code and SIPA, the lower courts tipped the scale in favor of foreign adjudication. As explained above and in the Trustee's brief, however, the statutory focus, properly placed, is on the domestic regulation of fraudulent transfers and the protection of U.S. securities markets and participants. These domestic interests are substantial and weigh in favor of adjudication in U.S. courts.

Finally, the concerns raised by the lower courts and now by Petitioners and *amici* – that the Petitioners received valid transfers under foreign law, with no direct relationship to BLMIS, and

without knowledge of BLMIS's fraud – are addressed by Bankruptcy Code § 550(b). An affirmative defense the burden for which rests upon the transferee, § 550(b) bars the Trustee from recovering property from "a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided." § 550(b)(1); *see Goldman v. Capital City Mortg. Corp. (In re Nieves)*, 648 F.3d 232, 237 (4th Cir. 2011) (calling § 550(b) an affirmative defense and placing the burden of proof upon the transferee). Indeed, the availability of these defenses belies the specter of international discord raised by Petitioners and *amici*.

Prescriptive comity, as a "rule of statutory construction[,] cautions courts to assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws. It thereby helps the potentially conflicting laws of different nations work together in harmony—a harmony particularly needed in today's highly interdependent commercial world." *Empagran*, 542 U.S. at 164–65.

Bankruptcy Code § 550(b) accommodates local law to the extent that Congress thought appropriate. It is designed to protect the legitimate interests of a party removed from the "defect" Congress seeks to regulate – the initial fraudulent transfer. *See Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 897 (7th Cir. 1988) ("Section 550(b)(1) implements a system well known in commercial law, in which a transferee of commercial paper or chattels acquires an interest to the extent he purchased the

items without knowledge of a defect in the chain."). The reliance by the bankruptcy court and the district court below on international comity as a basis to dismiss the Trustee's actions was legal error. SIPC submits that the Second Circuit was correct in holding that the interest in applying the U.S. Bankruptcy Code was paramount, and outweighs the interests of any foreign state.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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