

# Madoff: The Second Act

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*The author reviews what has happened in the roughly half year since the implosion of Bernard Madoff's investment firm, what is likely to happen before the end of 2010, and some open questions that are still to be resolved.*

Some events indelibly sear the memory of a group of people. Americans of a certain age always will know exactly where they were when President Kennedy died. Anyone, anywhere, with access to a television set will remember September 11, 2001 for the rest of their lives. Yet another, more limited group, also global in scope and not confined to a single generation, always will remember where they were on December 11, 2008 — the day they found out that Bernard Madoff was a fraud and their investments with him were gone.

As this is written, it is a little more than six months since the world's largest Ponzi scheme imploded. The first act of the drama has been played out, culminating with Bernard Madoff's sentencing to 150 years in jail on June 29, 2009. It seems a good time to review what has happened so far, to consider what is likely to happen in the next six months, and to try to peer beyond the curtain in search of answers to some questions which have not yet been resolved.

## ACT I: THE PAST SIX MONTHS

The admission by Bernard Madoff — among other things, a former chairman of the NASDAQ exchange — that his investment advisory business was merely a Ponzi scheme was stunning. It was Madoff's sons, also involved in the business, who called in the federal authorities. When the FBI agents knocked at Madoff's door to ask if there was an innocent explanation, he said no.

After Madoff's arrest, the SEC sued him and quickly obtained an order on consent freezing his assets. The Securities Investor Protection Corporation ("SIPC"), a private entity which provides limited insurance protection to customers of U.S. broker-dealers, obtained the appointment of lawyer Irving Picard as trustee for Bernard L. Madoff Investment Securities, LLC ("BLMIS") and commenced liquidation proceedings in bankruptcy court in New York. Although some victims later won the right to force Madoff into personal bankruptcy, and did so in April, the bankruptcy court ultimately accepted the trustee's argument that the affairs of BLMIS and Madoff were hopelessly intertwined and consolidated the two bankruptcy court proceedings in early June.

Victims of the fraud ran the gamut: the prominent and the humble; local governments; charities; prominent funds of funds and more modest employee pension funds. Victims surfaced from all over the globe, forming a veritable United Nations of the bilked. Several investment funds each had given billions of dollars in client funds to Madoff. A few well known funds announced that all of their monies had been invested with Madoff, and there was nothing left. The manager of one hedge fund with \$1.4 billion in losses committed suicide shortly after Madoff's arrest. When a list of purported Madoff customers, past and present, was published by the trustee in early February (available online at [www.madoffsearch.com](http://www.madoffsearch.com)), it contained over 13,500 names. Ultimately, over 15,000 claims for SIPC compensation were filed with

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the trustee by the July 2 deadline, although there were far fewer accounts.

An early, stunning revelation by the trustee was that BLMIS, despite claims of following a sophisticated investment strategy to minimize risk, had made absolutely no trades in the preceding 13 years. After the fact, it was easy to wonder how people could have believed in Madoff's claimed track record — for instance, of having lost money in only seven of 174 months ending in 2005, notwithstanding declines in that period in the general market. Even before the fact, however, a detailed letter complaining that Madoff's operation was a fraud had been sent by Harry Markopoulos to the SEC in 2005. Moreover, it developed that a 1992 fraud probe of two Florida accountants had led to Madoff's door, but did not go further, because the agency concluded that all of the investors' money had been accounted for at Madoff. On June 16, 2009, the SEC banned Madoff from association with any broker, dealer or investment advisor, firmly locking the door of the empty barn.<sup>1</sup>

### Criminal Cases and Government Actions

After several extensions of the government's time to file an indictment, Bernard Madoff waived indictment and pled guilty to an 11 count information on March 12. The United States charged him with securities fraud, investment advisor fraud, mail and wire fraud, several varieties of money laundering, making false statements to federal authorities, including the SEC, perjury and theft from employee benefit plans. The information alleged that the ostensible or notional value of the over 4,800 Madoff client accounts open at November, 2008 was \$64.8 billion, and the indictment averred that up to \$170 billion in assets should be subject to forfeiture. Unfortunately, actual BLMIS assets identified to that time amounted to only about 1.5 percent of the \$64.8 billion figure. In mid-June in a court filing before sentencing, federal prosecutors said the amount taken by Madoff likely was much less, approximately \$13 billion, based on early microfilm records located by the trustee, for 1,341 accounts.

Madoff entered a guilty plea before U.S. District Judge Denny Chin on March 12. In his guilty plea allocution, Madoff admitted running a Ponzi scheme, but dated its beginning only to the 1990s rather than

the 1980s, as alleged by the federal government. He insisted that he alone had been involved in the fraud, an assertion met with widespread skepticism. Judge Chin promptly revoked Madoff's bail, sending him to the Metropolitan Correctional Center in lower Manhattan, and the Second Circuit quickly affirmed that result.

Prosecutors sought the maximum sentence for Madoff, telling the court he had not provided "meaningful cooperation or assistance." In the days before the sentencing, the court approved a forfeiture order directed to Madoff's property, and also approved a deal between his wife and the U.S. Attorney's office, in which she surrendered claims to assets worth \$80 million.

In a June 22 letter to the court regarding sentencing, defense counsel argued against what was described as a "desire for a kind of mob vengeance," suggesting one of two more lenient sentences would be more appropriate: 12 years, based on that being a year shorter than Madoff's actuarial life expectancy; or 15 to 20 years, based on an analysis of other federal criminal sentences. Tellingly, however, of 42,000 cases with complete data, only 15 had involved losses exceeding \$400 million.

Ultimately, Judge Chin responded to the defense statement that neither mercy nor sympathy was sought by granting neither. He imposed a sentence of 150 years on the 11 counts (multiple sentences to run consecutively), describing Madoff's conduct as "extremely evil." Madoff stuck to his prior story, taking all the blame for himself and providing no information about other assets or accomplices. He will not appeal his sentence.

The only other criminal charges brought so far have been against the sole active practitioner at the tiny accounting firm which audited BLMIS, although federal prosecutors are said to be continuing with investigations of Madoff family members, former Madoff employees and others. The Serious Frauds Office in the United Kingdom has opened investigations. A Swiss prosecutor recently announced a probe of Santander Bank's Optimal Investment Services S.A., which had invested with Madoff, but said it might take up to two years.<sup>2</sup>

New York and Massachusetts law enforcement authorities have initiated civil proceedings against some of the funds which invested with Madoff. The

New York Attorney General sued funds run by J. Ezra Merkin, which had invested \$2.4 billion with Madoff, accusing Merkin of fraud; he agreed to surrender control of the funds to a receiver. The Massachusetts Secretary of State sued Fairfield Greenwich Group for civil fraud; one Fairfield Greenwich fund had invested (and lost) \$7 billion with Madoff. Massachusetts also levied a \$100,000 fine against Cohmad Securities, partly owned by Madoff, and revoked its business license, for not providing adequate information in a post-collapse investigation.

### Recovering Assets

About \$1.1 billion in BLMIS assets were locked down by the trustee from bank accounts, securities positions and other assets of BLMIS. Its proprietary trading arm, Castor Pollux Securities, was sold at auction for about \$25 million. More recently, Banco Santander agreed to settle potential preference period withdrawal claims by the trustee against its Optimal Investment Services, a Madoff feeder fund, for \$235 million. Just before his sentencing, Madoff's wife, Ruth, surrendered claims to \$80 million in property. Judge Chin also signed a forfeiture order directed to Madoff's assets, although its \$170 billion upper limit had little relation to the value of any assets Madoff has or ever had. Separately, Banco Santander offered a settlement in the form of preferred stock worth about \$1.8 billion, with some strings attached, to private bank customers of its funds whose monies had been invested with BLMIS through fund accounts; 93 percent of the customers have taken the deal.

The trustee has filed claims against various other funds based on their withdrawals during preference or clawback periods. The trustee also claimed that some of the funds or their principals were in on or should have been aware of the fraud; all told, he has sought some \$13.7 billion from eight groups of feeder funds or individuals associated with them based on their Madoff account withdrawals.<sup>3</sup> The trustee also has written to over 220 Madoff investors — individuals, Madoff employees and institutional investors — seeking information about some \$735 million in sums they withdrew during the six year clawback period under New York law.<sup>4</sup>

The trustee reports that he has issued some 230 subpoenas and identified 60 potential BLMIS-related

entities or interests, including in the following foreign jurisdictions: England; Gibraltar; Bermuda; the British Virgin Islands; the Cayman Islands; the Bahamas, Ireland; France; Luxembourg; Switzerland; and Spain. Other creditors have filed claims totaling about \$285 million. Administrative expenses advanced by SIPC through June 30 amounted to just under \$46 million.<sup>5</sup>

### Litigation

The courts are rife with Madoff-related lawsuits. Navigant Consulting reported in a May, 2009 paper<sup>6</sup> that 75 suits had been filed by the end of April (that was before the trustee's suits against feeder funds noted above), mostly by investors. More than 40 percent were class actions by investors; roughly a quarter were suits by institutional investors; 17 percent of the actions had individual victims as plaintiffs; and seven percent were shareholder derivative actions. Federal and state courts located in New York were the most frequent venues, accounting for 63 percent of the suits, followed by courts in California (11 percent) and Florida and Massachusetts, each with seven percent. Perhaps mindful of Sutton's Rule,<sup>7</sup> only a quarter of the suits named Madoff or related entities as defendants, while 76 percent named feeder funds, 72 percent named other individuals and 43 percent named accounting firms. Only eight percent named investment advisors.

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### SIPC Claims

Because BLMIS was a securities broker-dealer, its direct customers may be eligible for payment from SIPC's industry-funded insurance plan. The window for filing claims closed on July 2, 2009, by which time over 15,400 claims had been filed. Even before that, the trustee had ramped up the processing of claims made to SIPC. At May 28, he said that payments to about 250 claimants totaling about \$122 million had

been approved, most for the full \$500,000 available. As of July 9, claims from 561 victims had been approved, for payment of \$237.7 million against claims of \$3.01 billion.<sup>8</sup> The trustee also had put in place a hardship program for individuals in particularly dire straits, permitting expedited decisions on claims for post-1996 investors.<sup>9</sup>

Two adversary proceedings filed in early June in the bankruptcy court, one styled a class action, challenged aspects of how the trustee calculates the amount eligible for an SIPC payment.<sup>10</sup> Ignoring situations where withdrawals exceeded original deposits, the trustee's approach seems to be to take the amount of actual deposits, ignore the income and dividends investors thought they had earned, and then subtract withdrawals ("money in/money out"). Both adversary proceedings contend that the starting point should be the higher, notional value of the victims' accounts at the time of MBLIS' failure.

## Taxes

The Internal Revenue Service provided some certainty and some relief to direct investor victims of Madoff and other Ponzi-style schemes in April, with tax guidance, including a safe harbor assumption for calculating losses, subject to revision in individual cases based on future developments.<sup>11</sup> New York State also issued tax guidance.<sup>12</sup>

## Foreign Custodians

Several foreign officials have suggested that banks and other institutions which acted as custodians of funds invested with Madoff face liability to victims for losses.<sup>13</sup>

## ACT II: THE NEXT SIX MONTHS

### SIPC Claims

A clearer picture of the circumstances of the victims may emerge now that the final deadline for filing of SIPC claims has passed. A significant portion, perhaps a majority, of the most straightforward SIPC claims by individuals and entities who invested directly with BLMIS likely will be resolved by year's end, assuming the trustee's methodology is not up-

set, as will the thousands of duplicative claims or claims by apparently non-qualifying investors. The claims likely to be resolved most easily will be in two groups: those of accountholders whose original deposits substantially exceeded the amounts of their withdrawals in the last six years, but only up to the \$500,000 limit of SIPC coverage; and those of accountholders found to be ineligible, such as claimants who invested through feeder funds.

According to information submitted in connection with sentencing, there were only about 1,340 Madoff accounts which suffered losses, although about 4,900 accounts were "open" at the end of November and over 15,000 claims have been filed. That means there may be fewer than another 800 or so eligible claims to resolve. That figure presumably includes the 230 as to which there may be clawback claims, which may take longer to resolve. It also means that more than 14,500 claims could be denied, and that the SIPC's total advances may be under \$600 million — less than five percent of what the government now says real losses total. Through June 30, when the 30 day time period to file objections to trustee determinations with the bankruptcy court should have run on at least the first 250 claims determined, the trustee reported that only six objections had been filed.

Litigation by the trustee with feeder funds, as well as litigation or arbitration between or among the funds, their professional advisors and their investors, will be a main component of the work keeping lawyers busy well beyond year's end. The chief executive of the SIPC was quoted recently as saying it may take as long as ten years for the trustee to wrap up his work, but that presumably also includes the pursuit of subrogation claims on behalf of SIPC.

### Determining What SIPC Pays

Some court likely will have spoken by year's end on the disputes about what figure to use as the base for victims' claims and how to calculate net equity. Both of the adversary proceedings begun in June and mentioned above rely on the language of Section 7811(11) of the Securities Investor Protection Act, defining net equity, and a position taken by the SIPC in an earlier New York-based Ponzi scheme run by William Goren. Unfortunately, in that case, neither the SEC nor the Second Circuit agreed with the position

the SIPC took on valuation.<sup>14</sup>

In the Goren scam, statements issued to investors had shown some of their monies going into real mutual funds, while other sums were reported as having gone into funds which had existed only in Goren's imagination. The main issue on appeal was whether the money supposedly invested in funds which didn't exist should be treated as securities (SIPC coverage of \$500,000) or cash (only \$100,000 in coverage). The Second Circuit concluded that using the higher figure best meshed with the legislative intent to inspire confidence in investors dealing with broker-dealers. But on the precise question of what value should be used to peg the SIPC payments for the investments in the fictive funds, the court rejected the "net equity" argument urged in the two Madoff adversary proceedings. The district court had allowed victims to use the notional values shown on their statements; the court of appeals reversed. "[W]e adopt the view that the Claimants' net equity is properly calculated as the amount of money that the Claimants initially placed with the Debtors to purchase the [fictive] funds and does not include the artificial interest or dividend reinvestments reflected in the fictitious account statements that the Claimants received from the Debtors."<sup>15</sup> The opinion's discussion of the significance of the statements victims received showing dividends or income had to do only with deciding whether the broker was acting as a cash depository (\$100,000 limit) or in a custodial capacity (\$500,000 limit). Some other cases appear to support this view as well.<sup>16</sup>

The Peskin complaint advances two further claims. The trustee sought to deduct \$113,000 in funds withdrawn in the 90 day preference period by the Peskins, even though they also had deposited over \$470,000 in that same period. The complaint argues this means the Peskins have a defense to the preference claim because they gave "new value" to BLMIS within the meaning of 11 U.S.C. §547(C)(4). Moreover, it contends, the payments within the 90 day period were returns of the victims' own property, transferred to them in the ordinary course of business, and therefore no preference at all.

Of potentially broader significance, the complaint also argues that the trustee is acting in bad faith by offsetting withdrawals directly against the SIPC's obli-

gation to pay up to \$500,000, thereby minimizing the hit to SIPC's insurance fund (or the securities industry's need to top it up if it falls short). This argument has consequences only for claims above \$500,000. In practical effect, the question boils down to whether an offset for withdrawals is applied to the gross claim of a victim or to the amount recoverable from SIPC. To illustrate: suppose a million dollar Madoff investor made only one withdrawal, of \$400,000, on December 1, 2008. Under the trustee's approach, the investor receives only \$100,000 from SIPC. Under the approach urged in the Peskin complaint, the withdrawal, if it were deducted at all, would be deducted from the gross claim, meaning the victim receives the full \$500,000 from SIPC. This approach would make it much easier to calculate SIPC payments in many cases; it also could increase SIPC's tab substantially.

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What seems to be a minority of cases have been cited by commentators to support the proposition that Ponzi scheme victims might avoid clawback claims in whole or in part if they can show a contractual basis for believing they had profits — such as that they were promised a specific return — or if they are deemed to be entitled to a time value of money on the sums given to the schemes.<sup>17</sup> In hindsight, it may seem remarkable that SIPA does not specifically address the issue of investment in fictive funds (as in the Goren situation) or of the broker who made no trades (as, apparently, here). It may be noted, however, that the statute does appear to address how to treat fictitious income in another context. Section 7811(4) defines "customer property" as including "the proceeds of any such property transferred by the debtor [here, BLMIS], including property unlawfully converted." Thus, to the extent BLMIS stole customer funds and invested them in T bills, the interest on the T bills would be proceeds and would be treated as part of

customer property. Section 78fff-3(a) describes the SIPC insurance payments as advances, to constitute “such moneys, not to exceed \$500,000 for each customer, as may be required to pay or otherwise satisfy claims *for the amount by which the net equity of each customer exceeds his ratable share of customer property....*” (emphasis supplied). One way to read that provision is that customers must look to the overall recovery from the estate, if any, to recover proceeds on their monies realized by BLMIS to the extent the \$500,000 figure is exceeded — that is, that the fictive income is added to the customer property denominator but not to the net equity numerator.

## SEC Report

The SEC’s Inspector General’s report on the agency’s examinations and investigations of Madoff since 1992 is now slated to be released by the end of August.

## Some Further Questions

### *Mistake*

A number of claims have started to assert mistake as a basis for undoing Madoff transactions or collateral transactions. Thus, a complaint filed by one of the Fairfield Greenwich funds against Fairfield Greenwich and related persons and entities argues for rescission on the ground of mutual mistake. It avers that both the plaintiff and the defendants mistakenly thought Madoff was pursuing a legitimate split strike conversion investment strategy with the fund’s \$7 billion.<sup>18</sup>

A New York State trial level court refused to excuse a default on a contract to purchase a home where the buyer had been unable to close as the result of his Madoff losses; the court’s decision led to a further loss, that of the would be buyer’s downpayment.<sup>19</sup> In another still pending case, a divorced New York lawyer is urging a court to set aside a property allocation which let him keep the couple’s entire Madoff account, no longer as good a deal as it seemed at the time.<sup>20</sup>

A look back to the Great Depression suggests courts will use the mistake doctrine when unspoken assumptions in a contract, coupled with once in a life-

time economic upheaval, put innocent individuals in dire situations. The issue is likely to arise as well in other contexts not yet seen, such as life insurance trusts and gifts to charities.

Where a gift is involved, the mistake need not even be mutual. As one treatise notes, “When mistake induces the making of a gift, unilateral mistake of the donor is enough to support rescission and restitution of the asset transferred.”<sup>21</sup> Moreover, “The making of a gift may be influenced by an erroneous belief that does not relate either to the donee or to the property given. The matter could be and has been described as extrinsic or collateral, but that has not stood in the way of restitution to the mistaken donor.”<sup>22</sup> The mistake also can come to light as the result of events transpiring after the gift.<sup>23</sup>

*Dead Man’s Bluff.* There may be Madoff losses where the impact has not yet been realized. Hypothetically, imagine an estate where the principal asset of the decedent was a Madoff account. If the fiduciary of the estate was appointed and liquidated the account long before the bubble burst, the estate realized the full value of the account, and the proceeds likely were distributed. Can they be clawed back from the heirs and beneficiaries, if it develops that six year period withdrawals by the decedent and the estate exceeded the original deposits? The answer may vary from state to state; in New York, if there is a final decree of the Surrogate’s Court, the trustee may find he has been declawed. Although N.Y. S.C.P.A. §210(2)(b) gives the court long arm jurisdiction over distributees who received property wrongfully, presumably the standard of CPLR 5015 for relief from a judgment would have to be met. If more than a year has elapsed from service of a copy or from entry, excusable default will be unavailable as a basis, and the movant will have to show newly available evidence would have produced a different result but could not have been discovered in time to move for a new trial within the period allowed by CPLR 4404 (15 days after decision).

Now suppose the fiduciary was appointed in early 2008, but, for whatever reason, had not liquidated the account by December 11. A SIPC claim is available, but for a large estate, that may not provide full recovery. The fiduciary may face claims for having failed to liquidate the account while liquidation was

possible. Again, the consequences will vary from state to state. In New York, the fiduciary might be subject to a surcharge, either for having allowed the funds to remain in the Madoff account at all or for not having liquidated them promptly. In *In re Bingham's Estate*,<sup>24</sup> for example, the failure to redeem land sold for overdue taxes within the statutory window, which led to the inability of the estate to satisfy all of the decedent's obligations, led the court to surcharge the fiduciary for the value of an unsatisfied claim. Fiduciaries of estates which cannot meet obligations because their principal assets were in Madoff accounts may face greater liability than the \$348 at issue there. Courts may find parallels for treating trust or estate fiduciaries with how they treat ERISA fiduciaries which invested funds with Madoff.

In New York, however, there is a seven month window from the issuance of letters to the fiduciary for bringing a claim against an estate; if the deadline is not met, and there was no reason to know of the claim, the fiduciary cannot be held liable personally for any prior good faith payments to satisfy claims, legacies or distributions.<sup>25</sup> The situation is different if a claim incurred by the decedent is contingent or unliquidated at death; N.Y. S.C.P.A. §1804 sets out a different procedure for resolution.

This leads to another point. Accountants have been sued for failing adequately to audit BLMIS or Madoff feeder funds. What of accountants — or lawyers, or investment advisors — who recommended or perhaps even facilitated Madoff investments? Many, if not all, would plead they knew no better than their clients, and, at worst, were negligent. Depending on when the asserted negligence occurred, however, the time to make such a claim against the professional may be running out.

Again, the answer may vary from state to state. New York treats most non-health care professional malpractice as subject to a three year statute of limitations, and no longer allows this to be extended by pleading that the damaging conduct also violated the client's contract with the professional, thereby denying application of the more leisurely six year statute to the claim. (Advisors whom it was alleged knew Madoff was running a scam presumably can be sued within the six year fraud statute of limitations, or within two years after either December 11, 2008 or

when the fraud "could with reasonable diligence have been discovered" — although figuring out when that was could be the topic of a whole separate article.) It follows that malpractice claims by investors who were pointed to Madoff by New York lawyers and accountants without actual knowledge of the fraud before July 2006 may be time barred already.<sup>26</sup>

### **Cashing Out Claims?**

The trustee has taken steps to try to expedite the determination of claims from victims whose impoverishment by the Madoff fraud has placed them in the most desperate straits. Undoubtedly, however, there are numerous older victims whose situation is not so extreme, but who ill can afford to wait years for a resolution of their claims. In other situations with some similar characteristics, secondary markets have developed to allow individuals who cannot wait to realize the value of their claims to obtain some, albeit reduced, present value.

### **Forgotten Claims**

There will be some Madoff losses which never get claimed — for example, those of individuals resident in foreign countries whose investments were made in violation of currency control or capital export laws. The effect will be to increase modestly the recovery available to those not inhibited from stepping forward.

### **Money from Congress?**

Palliative legislation for the victims seems increasingly unlikely at this point. The start of SIPC payments, the generous tax treatment accorded by the IRS for losses, and the much larger economic problems playing out globally probably have taken much of whatever steam there might have been out of any effort to have Congress establish a dispute resolution mechanism for victims' claims. There was never

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likely to have been much enthusiasm for a Madoff-taken Assets Recovery Fund, however apt the resulting acronym might be.

Speaking of Congress, now that Madoff's personal bankruptcy and the BLMIS liquidation have been combined, it is worth noting that Bernard Madoff made a total of \$261,250 in reported campaign contributions to federal candidates in the six years preceding December, 2008. The number is even bigger if one includes contributions by family members and BLMIS employees. The trustee reported he had recovered some \$144,500 in political contributions, including from the seemingly non-partisan Police Athletic League. It might be an appropriate gesture for any campaign committees which still exist and which have kept those funds not to give the money to an unrelated charity, but to turn that money over for the benefit of impoverished victims. Alternatively, the trustee always could start a new type of clawback claim....

## NOTES

<sup>1</sup> *In the Matter of Bernard L. Madoff*, Admin Proceeding File No. 3-13520, available at <http://sec.gov/litigation/admin/2009/34-60118.pdf>.

<sup>2</sup> Thomas Catan, "Switzerland Investigates Santander," *The Wall Street Journal*, June 19, 2009, p. B2.

<sup>3</sup> Feeder fund or related defendants in trustee claims so far include: Fairfield Greenwich funds (Fairfield Sentry, Ltd., Greenwich Sentry LP and Greenwich Sentry Partners LP) (\$3.5 billion in withdrawals during six-year clawback period); Stanley Chais (sued for about \$1.1 billion); J. Ezra Merkin (Ariel Fund Ltd., Ascot Fund, Ltd. and Gabriel Capital Corp.) (sued for not quite \$558 million); Jeffrey and Barbara Picower, Picower Foundation and others (\$6.7 billion); Harley International (Cayman) Ltd. (\$1.1 billion). The trustee also pursued other claims seeking to clawback withdrawals, including against Kingate Global Fund, Inc. and Kingate Euro Fund Ltd. (\$395 million in withdrawals during 90-day preference period) and Vizcaya Partners, Ltd. (\$150 million in withdrawals during 90-day preference period). The trustee has asserted that Chais, Merkin, Picower and Harley knew or should have known something was amiss with Madoff.

On June 22, the trustee and the SEC filed civil suits seeking to recapture about \$114 million in fees paid by BLMIS against Cohmad Securities Corporation;

Maurice J. Cohn, its co-founder and chairman; his daughter, Marcia Beth Cohen, Cohmad's president and chief operating officer; and its vice president Robert M. Jaffe, son-in-law of Madoff investor Carl Shapiro. The SEC also sued Chais.

<sup>4</sup> See, e.g., *Avalon LLC v. Coronet Properties Co.*, 306 A.D.2d 62, 762 N.Y.S.2d 48 (1st Dep't. 2003).

<sup>5</sup> June 30, 2009 interim report of trustee, available at [www.madofftrustee.com](http://www.madofftrustee.com) (last viewed July 13, 2009).

<sup>6</sup> Jeffrey Nielsen, "Going After Money That's No Longer There," May, 2009.

<sup>7</sup> Bank robber Willie Sutton, asked why he robbed banks, reputedly told police, "Because that's where the money is."

<sup>8</sup> Diana B. Henriques, "It's Thankless But He Decides Madoff Claims," *The New York Times* (May 29, 2009); [www.madofftrustee.com/](http://www.madofftrustee.com/) (last viewed on July 13, 2009). According to the trustee's June 30 interim report, available at [www.madofftrustee.com](http://www.madofftrustee.com), 425 claimants had been asked to provide more information.

<sup>9</sup> The details of the program and an application are on the trustee's website, [www.madofftrustee.com](http://www.madofftrustee.com). The six factors to be considered are inability to pay necessary living expenses, such as food, housing, utilities or transportation; inability to pay necessary medical expenses; need for those over 65 to return to work; personal bankruptcy; inability to pay for care of dependents; and extreme financial hardship as demonstrated by other circumstances not set forth in the first five criteria. The trustee promised to decide (or seek more information in order to decide) hardship requests within 20 days, and to expedite determination of qualifying claims. Without making a promise, the trustee said he would try to decide qualifying claims for accounts opened after 1995 within a further 20 days. In view of poor records, however, accounts opened earlier will have to wait "until full information is available for resolution." According to the June 30 interim report by the trustee, 152 of 258 hardship claims had been granted. In some cases, undisputed amounts were paid while other aspects of the claim remain pending. Most of the rest of the claims related to accounts opened before 1996.

<sup>10</sup> *Albanese v. Picard* (the purported class action), Adv. Pro. No. 09-01265 (Brkcty. S.D.N.Y.); *Peskin v. Picard*, Adv. Pro. No. 09-01272 (Brkcty S.D.N.Y.) The class alleged consists of all those adversely affected by the trustee's definition of net equity, excluding the Trustee or related parties and excluding Bernard Madoff or related parties. Because it was averred that

the trustee's interpretation had scared off some victims who otherwise would have filed SIPC claims which would be barred after July 2, 2009, the complaint asked that the class members be deemed to have filed SIPC claims as of the filing of the complaint. On June 24, 2009, the bankruptcy court denied the request in the *Albanese* proceeding for an expedited determination on class claim status and damages, calling it "procedurally flawed and not justified."

<sup>11</sup> See Rev. Ruling 2009-9 and Rev. Procedure 2009-2. The rulings are highly complex and a detailed discussion is beyond the scope of this article. In any event, any taxpayer weighing whether and how to take a deduction should consult with a skilled tax advisor before doing so.

<sup>12</sup> TSB-M-09(7) I (May 29, 2009).

<sup>13</sup> See, "UBS, HSBC Have Duty to Madoff Investors, Freiden Says," Bloomberg (June 5, 2009 4:44 p.m.) (quoting the Treasury Minister of Luxembourg: "The principle is very clear: the custodian bank has to indemnify investors"). Luxembourg was the situs of funds said to have lost \$2.7 billion to Madoff. The director of the French Autorité des Marchés Financier had issued a similar statement in December.

<sup>14</sup> *In re New Times Securities Services, Inc.*, 371 F.3d 68 (2d Cir. 2004).

<sup>15</sup> *Id.* at 88.

<sup>16</sup> See, e.g., *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80 (2d Cir. 2002); *In re Bayou Group, LLC*, 396 B.R. 810, 885 (Brkcty S.D.N.Y. 2008) ("But in no event is it appropriate to pile fiction on fiction by deeming these investors' final Bayou Fund account statements, including fictitious profits, to be the value of their investments contributed to the Bayou hedge funds.").

<sup>17</sup> See, e.g., cases discussed in James B. Glucksman and Robert L. Rattet, "Ponzi Scheme Recovery: Investors, Brokers Versus Trustees," *The New York Law Journal*, January 30, 2009; Arthur J. Steinberg and John F. Isbell, "Protecting Redemptions in a Ponzi Scheme Case," *The New York Law Journal*, March 2, 2009.

<sup>18</sup> Complaint in *Fairfield Sentry Limited v. Fairfield Greenwich Group*, Index No. 09-601687 (Sup. Ct. N.Y. Co., filed May 29, 2009), ¶¶ 102-105.

<sup>19</sup> *Sassower v. Blumenfeld*, (Sup Ct. Nassau Co.), N.Y. L. J. May 13, 2009, p. 40.

<sup>20</sup> "Blaming Madoff, man sues over divorce settlement," Reuters (February 5, 2009 12:20 p.m. EST).

<sup>21</sup> 4 Palmer, *Law of Restitution* (1978), §18.2. Accord: *In re Clark's Estate*, 233 A.D. 487, 253 N.Y.S. 524, 528 (4<sup>th</sup> Dep't 1931)("[E]quitable relief, by way of rescission, can be granted in a case like this where the gift was the result of a material mistake of fact on one side only.") See *Vogel v. City Bank Farmers' Trust Co.*, 152 Misc. 18, 272 N.Y.S. 643 (Sup. Ct. N.Y. Co. 1934); *Reuther v. Fidelity Union Trust Co.*, 116 N.J. Eq. 81, 172 A. 386 (Ct. Err. & App. 1934). See also *In re Kaufman Estate*, 27 Pa. D. & C.2d 201, 206 (Pa. Orph. 1962).

<sup>22</sup> Palmer, *supra*, at §18.6, p. 26.

<sup>23</sup> In *Lederman v. Lisinsky*, 112 N.Y.S.2d 203 (Sup. Ct. N.Y. Co. 1952)(not officially reported), for example, a widow had created irrevocable trusts to benefit two of her children prior to remarrying. A primary purpose of the trusts was to allay concerns that her new husband would prevail upon the widow to give him the funds, to the daughters' prejudice. The new marriage ended in divorce. Thus, the foundational assumption undergirding the trusts' creation as irrevocable — that they were needed to protect the funds for as long as she lived, because the new marriage would last as long as the widow lived — turned out to have been sadly mistaken. The court concluded: "...I think I will not be doing violence to the equitable doctrine of rescission because of mistake [citation omitted] by holding that under the circumstances of this case plaintiff's notion as to the meaning and effect of the word 'irrevocable' constitutes such a mistake as will entitle her to a rescission of the trusts provided she establishes another which will give the children substantially as great rights as they have under the existing indentures." *Id.*, 112 N.Y.S.2d at 207.

<sup>24</sup> 17 N.Y.S.2d 981 (Surr. Ct. Oneida Co. 1940) (not officially reported).

<sup>25</sup> N.Y. S.C.P.A. §1802.

<sup>26</sup> If, however, the investor has died, her estate has a post mortem year to bring a claim, at least in New York (CPLR 210(a)); minors and those under a disability, again, in New York, have even longer (CPLR 208). Similarly, if there is a basis for an indemnification claim, that claim may not be time-barred.