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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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In re:	: SIPA LIQUIDATION
	:
BERNARD MADOFF INVESTMENT SECURITIES LLC,	: No. 08-01789 (BRL)
	:
	:
Debtor.	: Adv. Pro. No. 09-01272(BRL)
	:
-----X	
	:
DIANE and ROGER PESKIN, and MAUREEN EBEL,	:
	:
Plaintiffs,	:
	:
v.	:
	:
IRVING H. PICARD, as Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC,	:
	:
Defendant.	:
-----X	

BRIEF OF AMICUS CURIAE

The briefs of the plaintiffs, and those of other plaintiffs filed in related cases, cover several crucial points relating to the proper definition of net equity. They

elaborate, for example, the legislative history of SIPA, the views previously followed and/or expressed by SIPC, and the decision in the *New Times* case. There are, however, some points of consequence which either have not been brought to the Court's attention at all, or have been brought to its attention only cursorily. Three such matters shall be discussed here.

1. The first is the long term consequence, when distributing the monies collected for the estate by the Trustee, of the definition of net equity adopted by SIPC and the Trustee. As is well known, their method of calculating net equity -- cash-in minus cash-out -- wipes out the net equity of many victims of Madoff who would have a positive net equity if it were based on the November 30, 2008 statements. The number of persons whose net equity is eliminated by the unusual cash-in/cash-out method of determination is likely in the high hundreds or the thousands; only the Trustee and SIPC know, and they have not said.

The consequences of eliminating a victim's net equity has generally been discussed in connection with the fact that it will correlatively eliminate a victim's ability to obtain any part of the \$500,000 that otherwise would be available from SIPC. But it has another consequence as well. The elimination of a victim's net equity will also eliminate the victim's ability to obtain a share in the monies which the Trustee collects for and distributes from the estate. If one has no net equity, one will not share in the estate. (Neither SIPC nor the Trustee has denied this although it was stated publicly by amicus in his writings and although they have demanded retraction and corrections when they were of the opinion that a statement by amicus in his writings was incorrect.)

The loss of any right to share in the monies recovered for and distributed from the estate by the Trustee is no light matter. The Trustee has brought lawsuits for amounts variously estimated as ranging from approximately ten billion to approximately thirteen billion dollars. He may bring more suits for more billions. Some of the defendants he sues could prove to have deep pockets, so that success on the Trustee's part would recover billions for the estate. But if SIPC and the Trustee have eliminated a victim's net equity by use of the cash-in/cash-out method, that victim will get nothing from the monies recovered for and distributed from the estate. The victim will not share in those monies.

Making this fact even more dubious is that the persons who will not share in the estate because of the absence of net equity -- just like they will not share in recovery from SIPC itself -- are almost certain to be those who can least afford it. They are unlikely to be the very wealthy who put twenty or fifty or 200 million dollars into Madoff and did not have to, and did not in fact, take money out of Madoff in order to live and in order to pay taxes on phantom profits from Madoff. The very wealthy are unlikely to be the persons who withdrew monies for these purposes and who therefore have a negative net equity under the cash-in/cash-out calculation. Rather, the people who will have no net equity under such calculation, and who will not share in distributions from the estate (or from SIPC) are almost certain to be those of far lesser means. They are almost certain to be those who were able to put in only a few hundred thousand dollars or perhaps a million dollars, who watched this grow over one or two decades (or more) until they began taking out money to live and pay taxes in their senior years, and who now are wiped out.

It is perhaps not irrelevant that the Trustee and SIPC are the only ones who can know, *but they are not disclosing*, the numbers of persons who will be desperately harmed by the cash-in/cash-out method because it wipes out their net equity. The Trustee and SIPC are likewise the only ones who know, *but they again are not disclosing*, the numbers of very wealthy persons who will *not* be harmed by cash-in/cash-out because the amounts they invested, *as shown in the files to which the Trustee has access*, were so huge, and who will in fact obtain a greater share of distributions from the estate because the less affluent will *not* share in distributions due to their net equity being eliminated by use of cash-in minus cash-out.

One could think the failure of the Trustee and SIPC to disclose these comparative numbers speaks volumes.

It is fair to ask whether use of a method of calculation -- cash-in/cash-out -- which is so harmful to so many comports with Congress' clearly expressed intent, discussed in other briefs, that SIPA help restore confidence in markets (rather than be used in a way which destroys confidence by dramatically injuring small investors).

2. There has been extensive dispute, in public writings and in briefs filed in this case, over the reasons for and the propriety of using the cash-in/cash-out method of calculating net equity. On the side of the Trustee and SIPC the major arguments appear to be that using the November 30th statements to determine net equity would allow the fraudster to determine individuals' returns and to do so with arbitrary favoritism, would open the door to arbitrary returns unhinged from reality, and that investors who took out all that they put in or more than they put in (so-called net winners) should not get more

money when there are persons who left their money in Madoff and are so-called net losers. On the other side it has been argued:

- that persons who innocently took out monies had a legitimate expectation that the money was theirs and a legitimate expectation that the amounts they still had in Madoff were the sums shown on their monthly statements;
- that such persons are often the least affluent of Madoff's victims, therefore had to take out monies to pay living expenses and to pay income tax on phantom profits, are now often destitute, and should not be further victimized by denial of their legitimate expectations;
- that *New Times* set its face against use of cash-in/cash-out instead of brokerage statements where real securities were the ones the fraudster claimed to be buying;
- that SIPC officials told courts and the public that SIPC would credit a person with the amounts shown on his/her monthly statement even if securities had never been bought;
- that the Trustee has been able to identify only a miniscule number of people who benefitted from returns higher than those given the *vast* majority of investors and that the miniscule number of special beneficiaries were all culpable participants in the fraud in one way or another and should therefore receive *nothing* from SIPC;
- that rather than returns being arbitrarily different among the vast majority of investors, they appear to have been pretty much alike and, were it otherwise, there are standard measures of returns that could be used to avoid arbitrariness¹;

¹ Such standard measures include the return on the S&P 100 (since Madoff claimed to be buying S&P 100 stocks), the return on the Dow, the return on Treasuries, prevailing interest rates, and other possibilities.

- and, of special importance to the question of discovery to be discussed below, that the real reasons SIPC and the Trustee adopted the cash-in/cash-out theory were that use of the November 30th statements would cause SIPC to have to pay out amounts of money far greater than it possessed or even had access to, and that this would have caused difficulties for SIPC, for its management (which might have been replaced), and for the Wall Street brokerage community that comprises the membership of SIPC and would have had to be assessed large sums of money.²

The question raised in the last bulleted point above -- the question of the real reason(s) why SIPC and the Trustee adopted the cash-in/cash-out theory to determine net equity in this case -- is of the first importance. For if SIPC and the Trustee did adopt cash-in/cash-out here in order to avoid huge problems for SIPC and its management that would arise from the standard practice of using amounts shown in brokerage statements, then this would show the following, conclusively or nearly so: it would show that, for the financial and business purposes of aiding SIPC, its management, and the brokerage community, cash-in/cash-out was used here even though its use frustrated Congress' intent to help investors obtain their legitimate expectations.

With such a major question at stake, it would seem plain that discovery should be had to shed *factual* light on the question. It equally would seem insufficient to rely on mere (unsworn) claims one way or the other. The *factual* truth, rather, should be established by document discovery and depositions.

True, there are those on the plaintiffs' side who believe that the plaintiffs' arguments based on legislative history, *New Times*, prior SIPC statements and SIPC

² Even using the cash-in/cash-out method, SIPC has had to heavily increase its assessments on brokers, which has caused no little consternation in the brokerage community.

actions regarding net equity, and the case law of legitimate expectations are all so strong that discovery of SIPC's motivation here is unnecessary and could not change the result no matter what is found -- could not change the result even if discovery were to show that SIPC did *not* adopt cash-in/cash-out because of a desire to save itself, save its management, and aid the brokerage community while sacrificing the interests and legitimate expectations of investors. Truth to tell, as a matter of personal belief, amicus agrees with that. Nevertheless, discovery is necessary in order to establish the truth about SIPC's motivation one way or another, and could be of aid not only to this Court, but to all reviewing courts, in understanding how and why SIPC and the Trustee came to eventually adopt cash-in/cash-out³ and in understanding the impact of this on Congress' intent.

Discovery would also shed factual light on other relevant points. It would show, for example, how many of Madoff's victims will have their net equity wiped out by use of the cash-in/cash-out method, how many such victims could be considered to be among the less affluent ones because they only put in a few hundred thousand dollars or, over time, no more than one million dollars or so, how many Madoff victims whose net equity is *not* eliminated by cash-in/cash-out could be considered among the very wealthy (e.g., persons who put, say, fifteen or twenty million dollars or more into Madoff), and the extent to which the very wealthy, whose net equity will *not* be wiped out, will receive more from the estate because the net equity of the less affluent *will* be wiped out.

³ The adoption was eventual rather than immediate since, as far as amicus is aware, SIPC and the Trustee did not publicly announce that they would use cash-in/cash-out until long after SIPC entered the case, perhaps not until a mass meeting held by the Trustee on February 20th. Also, the General Counsel of SIPC was quoted as initially saying that the amounts victims would be regarded as having lost were the amounts on their last statements.

3. *Visconsi v. Lehman Bros. Inc.*, 244 Fed. Appx. 708, 2007 WL 2258827 (C.A.6) (Ex.) involved a notorious fraud perpetrated by Frank Gruttadauria. Gruttadauria's fraud was very analogous to a Ponzi scheme, since he used investors' money for his own purposes instead of investing it as promised, and "When a client would request all or a portion of her investment funds, Gruttadauria would transfer money from one client to another" in order to meet the request. Ex., p2. ("Throughout this period, Plaintiffs made periodic withdrawals from their accounts amounting to 25.8 million, which Gruttadauria paid *"using funds from other clients."* Ex., p. 3 (emphasis added).)

Like Madoff, Gruttadauria "hid this extensive fraud by sending false account statements to his clients, which purported to summarize their respective investment portfolios." *Ibid*, p.2.

The investors in the case invested \$21 million with Gruttadauria. Over the years they withdrew \$31.3 million, but at the end their account statements, due to phantom profits, showed \$37.9 million (when in reality their accounts had only a few thousand dollars.) *Ibid.*, pp 3, 5, 6. Lehman Bros., which had been Gruttadauria's employer, argued for an "out-of-pocket theory of damages," a theory which the Sixth Circuit found to be "wholly without merit." Although the appeal sought to overturn an arbitration award, so that much of the court's opinion was therefore devoted merely to the usual statements about the difficulty of overturning such awards absent manifest disregard of law, the Court was declarative and definitive with regard to the impropriety of the out-of-pocket measure of damages with regard to the Ponzi-like fraud committed by Gruttadauria:

Lehman's out-of-pocket theory misapprehends the harm suffered by Plaintiffs and the facts of this case. Plaintiffs gave \$21 million to Gruttadauria, not to hide under a rock or lock in a safe, but for the express purpose of investment, with a hope-indeed a reasonable expectation-that it would grow. Thus, the out-of-pocket theory, which seeks to restore to Plaintiffs only the \$21 million they originally invested less their subsequent withdrawals, is a wholly inadequate measure of damages. Had Gruttadauria invested Plaintiffs' money as requested, their funds would have likely grown immensely, especially considering that Plaintiffs invested primarily throughout the mid-1990s, which, had they hired an honest broker or a watchful company that reasonably supervised its employees, would have placed their money in the stock market during one of the strongest bull markets in recent memory. In fact, the fictitious statements issued by Lehman, which were designed to track Plaintiffs' funds as if they had been properly invested, indicate that Plaintiffs' accounts would have grown to more than \$37.9 million (even accounting for the withdrawal of more than \$31.3 million). Plaintiffs thus could have reasonably believed that they were entitled to the full \$37.9 million balance shown, regardless of the amounts of their previous deposits and withdrawals. We therefore reject Lehman's argument because it is founded on an improper-and wholly inadequate-measure of damages.

The question in *Visconsi*, of course, was the proper measure of damages and the question here is the proper measure of net equity. But the two questions are in reality the same because they both came down to what is the proper way to measure the amount remaining to an investor in a Ponzi or analogous scheme where the investor put in money, took out more than he put in, but thought he nonetheless had extensive amounts remaining in his account because he received statements showing this was the case due to purported earnings -- due to phantom profits. SIPC and the Trustee say you measure the amount remaining to an investor by an out-of-pocket calculation of the amount the investor put in minus the amount he took out. The Sixth Circuit has ruled that this

measure is “wholly without merit”, and is “improper and wholly inadequate,” because the victim gave the culprit money “*not to hide under a rock or lock in a safe, but for the express purpose of investment, with a hope -- indeed a reasonable expectation -- that it would grow.*” (Emphasis added.)

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing Motion and Brief Amicus Curiae to be served on counsel listed below by first class mail, postage prepaid, on this 13th day of August, 2009.

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