

# New York Law Journal

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## **Free: Trustee, Madoff Investors Spar Over Payout Calculation**

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02-03-2010

The attorney for the bankruptcy trustee recovering the assets of Bernard L. Madoff argued before a packed courtroom yesterday that "no one in their right mind" would use the financial statements concocted by Mr. Madoff as a basis for distributing the funds.

During a nearly four-hour hearing, David J. Sheehan, an attorney for trustee Irving H. Picard, urged Bankruptcy Judge Burton Lifland to accept Mr. Picard's "cash-in/ cash-out" method of compensating investors.

Under that approach, investors who withdrew less cash from their Madoff accounts than they deposited ("net losers") would share in whatever Mr. Picard recovers, now about \$1.5 billion.

On the other hand, investors who withdrew funds over and above what they invested ("net winners") would get nothing.

Investors who object to Mr. Picard's plan insist that any payout should be based on what Mr. Madoff, 71, claimed they made as recorded in their Nov. 30, 2008, statement from Bernard L. Madoff Investment Securities LLC, just two weeks before Mr. Madoff was arrested for his multi-billion dollar Ponzi scheme.

Mr. Sheehan contended at the hearing that the approach of the objecting investors would "ignore the reality" of a Ponzi scheme.

"The last customer statement, being the concoction of a fraudster, is not something on which you can rely" in calculating net equity, said Mr. Sheehan, a partner at Baker & Hostetler.

In fact, that would only "reinforce Bernie's fraud," he claimed. "It's really sad that some of my colleagues have led people down the wrong path," he said of the attorneys representing victims of Mr. Madoff's fraud.

Stressing that about \$600 million has been distributed to investors so far, Mr. Sheehan said "the trustee understands his responsibilities" under the Securities Investor Protection Act of 1970. And he tried to dispel notions that the Securities Investor Protection Corp. (SIPC), a federally mandated non-profit agency created to protect customers of failed brokerage firms, has an insurance fund to compensate victims.

According to Mr. Sheehan, while investors can receive up to a \$500,000 advance from the agency, that is only after someone has "already determined that you have an allowed claim."

"There's no insurance. There's no \$500,000 that everyone gets a check for. I don't understand why people don't get that," he told Judge Lifland.

But Brian J. Neville of Lax & Neville in Manhattan said the trustee's method was contrary to 80 years of precedent in securities law and a throwback to the discredited concept of "buyer beware." He said that SIPC, which acts as a "backstop" when a brokerage firm fails, had clearly "failed the Madoff victims."

Helen Davis Chaitman, a partner at Phillips Nizer who has blasted Mr. Picard for his method of calculating claims and accused him of violating the mandates of SIPC, agreed that the agency had let down investors.

Herself a victim of Mr. Madoff's fraud, Ms. Chaitman, who represents both "net winners" and "net losers," said that investors like Adele Fox, an 86-year-old retired schoolteacher who "lost everything to Madoff" had a "reasonable belief" she would receive at least \$500,000 in "insurance" from SIPC. To the hundreds "of Adele Foxes I represent, that \$500,000 is the difference between living" with or without bleeding ulcers, Ms. Chaitman said.

She also accused SIPC of ignoring warnings from Congress that it was "grossly underfunded" and said that the agency, which had \$1.7 billion at the time Mr. Madoff's fraud was uncovered but faced roughly \$2.45 billion in exposure as a result of the scheme, was "saving money at the expense of the investors."

Ms. Chaitman told Judge Lifland that accepting the trustee's methodology would lead investors to move their accounts every time there was an appreciation and result in a "musical chairs of brokerage firms."

Both sides relied heavily on the Second Circuit's ruling in *In re New Times Securities Services Inc.*, 371 F.3d 68 (2004), which involved a 17-year Ponzi scheme in which hundreds of investors were defrauded out of approximately \$32.7 million.

Mr. Sheehan cited the case for the proposition that basing customer recoveries on "fictitious amounts in the firm's books and record" would enable customers to recoup "arbitrary amounts that have no relation to reality."

However, Ms. Chaitman and other victims' lawyers contended the case meant that a customer's "legitimate expectations," based on written confirmations of transactions, should be protected.

Judge Lifland suggested that parties might wind up arguing their differing views of the case to the Second Circuit.

The judge, who said he had received 27 briefs from attorneys representing investors objecting to Mr. Picard's methodology and 22 submissions from pro se individuals, reserved a decision on yesterday's motions.

But he warned attorneys and victims, "No matter how I come down and rule, it's going to be unpalatable to one party or the other."

As of Jan. 29, the Madoff trustee Web site valued the total number of "allowed claims" at roughly \$5.1 billion, which exceeds the statutory limits of SIPC protection by approximately \$4.5 billion.

Mr. Sheehan suggested at the hearing that the trustee could recover as much as \$8 billion in assets.

#### Fraud Suit Dismissed

In other Madoff-related news, a federal court on Monday threw out civil securities fraud claims brought by the Securities and Exchange Commission against New-York based broker dealer Cohmad Securities Corp. and three of its executives.

"Nowhere does the complaint allege any fact that would have put defendants on notice of Madoff's fraud," wrote Southern District Judge Louis Stanton. "Rather, the complaint supports the reasonable inference that Madoff fooled the defendants as he did individual investors, financial institutions and regulators."

The regulators said the defendants were crucial to Madoff's success because they gave the impression that one could only invest with Madoff as a favor through special access (NYLJ, June 23, 2009).

In his ruling, the judge noted that Madoff had operated his business since 1960 and that Maurice Cohn, the company's chairman, is Mr. Madoff's former neighbor.

Cohmad was formed in 1985 and Mr. Cohn's daughter, Marcia, its chief operating officer, joined in 1988, three years before Mr. Madoff says he began operating his business as a fraud, the judge said. He also noted that the Cohns worked in Cohmad's New York office on the same floors as Madoff's legitimate market-making business.

Robert Jaffe, Cohmad's vice president and broker, who lives in Palm Beach, Fla., previously headed Cohmad's Boston office. He is a son-in-law of Carl Shapiro, a prominent Boston-area businessman and philanthropist whose family was said to have lost hundreds of millions of dollars from their investments with Mr. Madoff.

In its complaint, the SEC said Mr. Madoff directed Cohmad and its executives to maintain a cloud of secrecy about his business and banned all written marketing materials, cold calls and e-mails. It said he also told the defendants he would not accept investors in the finance and banking industry because sophisticated investors ask too many questions.

The defendants countered the allegations by saying an aura of exclusivity is a common marketing tactic.

The judge rejected the SEC's conclusion that the defendants' fraudulent intent could be inferred from allegations that Cohmad failed to disclose the full extent of its relationship with Mr. Madoff in its regulatory filings and books and records.

He said the argument "that concealment was because any defendant knew that Madoff was committing fraud is speculative and flimsy."

Judge Stanton gave the SEC permission to replead if it could provide facts to back up its allegations.

A suit filed by Mr. Picard in June, which accused Cohmad of recouping decades of "ill gotten gains" as a result of the firm's "symbiotic relationship" with Mr. Madoff, is pending before Judge Lifland. Cohmad has moved to dismiss the trustee's suit as well.

Mr. Madoff, who was sentenced to 150 years in prison in June, is incarcerated in a medium security facility in Butner, N.C.

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