Written Testimony of Helen Davis Chaitman

March 10, 2011

My name is Helen Davis Chaitman. I am a partner with the law firm of Becker & Poliakoff LLP in New York City. I represent approximately 500 people who lost their life savings in Bernard L. Madoff Investment Securities, LLC. I myself lost my retirement savings in Madoff.

My clients were victimized by the inexplicable failure of the SEC to shut Madoff down, despite seven investigations of Madoff over a 16-year period.

My clients have been further victimized by the inexplicable failure of the SEC to enforce the Securities Investor Protection Act against the Securities Investor Protection Corporation. SIPC has violated the law and the SEC has allowed it to do so. It is not simply my opinion that SIPC has violated the law. Congressman Scott Garrett has stated his view that SIPC and its trustee, Irving Picard, have violated the law in the Madoff case. Both Ileana Ros-Lehtinen and Peter King have co-sponsored Mr. Garrett's bill, H.R. 757, which will remedy the terrible injustice that the SEC has caused.

The SEC is charged under SIPA with the obligation to go into court and seek an order compelling SIPC to comply with the law. Yet it has failed to do so in the Madoff case. Perhaps the reason for its failure is the conflict of interest of its general counsel, David I. Becker. I leave that conclusion to you, but I want to give you certain facts that may assist in your deliberations.

Bernard L. Madoff confessed on December 11, 2008 and the SEC then filed a liquidation proceeding against his investment firm. It quickly became apparent that SIPC was going to reneg on its statutory obligation to insure each investor's account up to $500,000 based on the investor's last statement. This insurance money was absolutely crucial to thousands of Madoff investors who had invested their savings in Madoff and were left destitute at a time in their lives when they were most fragile because they could no longer work.

On April 2, 2009, I sent a letter to Mary Schapiro explaining that SIPC and Mr. Picard were taking the unlawful position that investors are not entitled to claims in a SIPA liquidation based upon their last statements (as required by SIPA). See Exhibit A hereto. In order to save itself approximately $1 billion, SIPC was taking the position for the first time in its history that Madoff investors' accounts are only insured for their "net investment" over a period of up to 50 years. This deviation from the law allowed SIPC to avoid paying half of the Madoff investors any SIPC insurance. This half happened to be the most elderly and neediest of all the Madoff investors. This deviation also greatly reduced the amount of insurance SIPC would pay to those investors who had a positive net investment.

I explained in my letter to Ms. Schapiro that the SEC has the obligation to enforce SIPA in situations where SIPC is violating the law. After all, SIPC is an insurance entity established by Congress whose members are the SEC-regulated broker/dealers. Investors are the insureds under the SIPA statutory scheme. It is natural that SIPC, like any insurance company, would seek to deny insurance to investors who are entitled to it. Under the statutory scheme, it is the SEC that is responsible to protect investors and enforce the law against SIPC. SIPC's wrongful denial of insurance to investors had been brought to the attention of the SEC in previous liquidations. So this was nothing new.

Instead of protecting Madoff investors and assuring continued confidence in our capital markets, the SEC endorsed SIPC's plan to cheat Madoff customers of their promised insurance, further victimizing them. I explained the law to Ms. Schapiro and asked her to intercede.

In my letter, I raised another issue of vital importance to Madoff victims: Irving Picard, the SIPC trustee, announced in February 2009 that he was going to sue innocent investors for money they withdrew from their accounts on the theory that they were only entitled to keep their net investment over a period of 40-50 years. Mr. Picard's lawsuits have been given the name "clawback" suits. In my April 2, 2009 letter, I asked Ms. Schapiro to propose an amendment to the Bankruptcy Code to clarify existing law so that innocent investors who relied upon the SEC to police the securities markets would not be forced to litigate clawback suits brought by Mr. Picard seeking to force investors to pay back money they withdrew from their Madoff accounts in the honest and legitimate belief that the money was theirs.

The clawback issue was inextricably inter-twined with the issue of how a customer's claim was calculated because the Trustee had announced his intention to "claw back" withdrawals in excess of each investor's net investment. Many Madoff investors were third generation investors. Their grandparents had established their accounts in the 1960's and 1970's. Of course, the money had appreciated and, even if the only withdrawals from the accounts were to pay taxes on the reported appreciation, these investors would have taken out, over three generations, far more than they had invested. But it is grossly inequitable and inconsistent with the law to permit a SIPC trustee to claw back from innocent investors who invested through an SEC-regulated broker/dealer.

Ms. Schapiro had Thomas McGowan of the SEC respond to my letter on April 23, 2009. He invited me to meet with him in Washington, which I did. At the meeting, I explained, again, the position of my clients and asked Mr. McGowan what authority there was to support SIPC's position in this case. He cited to me a 1926 decision of the United States Supreme Court in a case involving a preference claim -- a claim to recover payments received within 120 days of a bankruptcy -- that was decided 44 years before SIPA was enacted and 52 years before the present Bankruptcy Code was enacted. In short, the SEC had no authority for its support of SIPC's unlawful position.

On May 1, 2009, counsel for numerous other investors sent a letter to David Becker, again laying out the legal authority compelling SIPC to insure each account up to $500,000 based on the customer's last statement and urging the SEC to fulfill its statutory obligation to enforce the law against SIPC. See Exhibit B.

On July 14, 2009, Ms. Schapiro testified before the Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises. In response to a question from Congressman Ackerman as to when and how much the Madoff victims would be compensated by SIPC, Ms. Schapiro stated:

> I am committed to working as aggressively as we possibly can with SIPC to take the most expansive possible view of how to repay these claims and to do it in as quick a fashion as they possibly can.

7/14/09 Tr. at 18.

The Madoff liquidation was seven months old when Ms. Schapiro made that statement and, by that time, only a handful of investors had received SIPC insurance and only for the net investment over the life of their accounts, going back generations. Thus, up to that point in time, it is difficult to imagine what Ms. Schapiro was referring to when she spoke of her commitment to work as aggressively as possible with SIPC to repay claims as quickly as possible.

Unfortunately, after Ms. Schapiro's testimony, the SEC took precisely the opposite position from her purported commitment. Although SIPA requires SIPC to "promptly" replace securities up to $500,000 of investors whose brokers never purchased the securities shown on their statements, something SIPC has boasted can be done in 60 days, in the Madoff case there are still investors with valid claims who have not been paid their SIPC insurance 28 months after the liquidation was filed.

Moreover, the SEC has supported SIPC in taking the position that investors are only entitled to SIPC insurance if -- over the life of the account spanning as much as 50 years -- the investor, his parents, and grandparents, invested more money in Madoff than they withdrew. This position means that no customer can rely on his account statement. It is simply astonishing that the agency charged with protecting customers would take the position that federally-mandated statements are of no legal significance despite the fact that they are the only evidence any investor has of what he owns.

As an American citizen, I cannot explain the SEC's utter failure to enforce a law that was specifically enacted to protect investors. Nor can I explain the SEC's protection of SIPC in the face of its violation of the law.

We live in an era where investors cannot purchase certificated securities. The only proof any investor has of what he owns is the statement he receives from his broker. If investors cannot rely upon their statements, they cannot safely invest in the stock

market. I would have thought that assuring safe investments would be the primary purpose of the SEC.

I am not here to opine on whether Mr. Becker's patent conflict of interest influenced the grossly inappropriate behavior of the SEC in the Madoff case or the incorrect testimony of Ms. Schapiro on July 14, 2009. On the one hand, one could admire Mr. Becker for advocating a position that was adverse to his own personal interests. Clearly, by endorsing SIPC's illegal "cash in/cash out" methodology, Mr. Becker was increasing the chances of his being sued by Mr. Picard. On the other hand, Mr. Becker apparently considered that he had little risk of a clawback suit and I am certain that Mr. Picard would not have sued Mr. Becker if he had realized he was suing the SEC General Counsel. Indeed, Mr. Harbeck issued a statement recently admitting that Mr. Picard did not know he had sued this David I. Becker.

Moreover, the SEC, under Mr. Becker's watch, has advocated a "constant dollar" adjustment to the net investment calculation to mitigate the harshness of SIPC's position. Just as there is no basis in law for SIPC's position, there is no basis in law for the SEC's "constant dollar" proposal. And of course that proposal, if adopted, would certainly have benefited Mr. Becker by reducing his clawback exposure.

In any event, the reason people are not permitted to participate in policy decisions when they have a personal interest is to avoid their judgment being clouded. Clearly, in this case, I can say with confidence that Mr. Becker's judgment was clouded. He advocated a position which, as Congressman Garrett has stated, is a flat violation of the law.

But I do want to impress upon you the devastation that the SEC's position has caused to thousands of Madoff investors. It is impossible to explain to Madoff investors who were victimized by the SEC's failure to shut Madoff down in 1992 how the SEC could victimize them again by depriving them of the $500,000 in SIPC insurance which the law guarantees them, based upon their last statements.

There is one way that Congress can rectify the damage that the SEC's unlawful conduct has caused and that is to quickly enact Congressman Garrett's H.R. 757. Every Madoff investor is entitled to this relief. Every American who invests in the stock market is entitled to this relief. I ask that you provide it.

EXHIBIT A

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April 2, 2009

Commissioner Mary Schapiro
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Dear Commissioner Schapiro:

I write on behalf of approximately 350 investors in Bernard L. Madoff Investment Securities, Inc. ("Madoff"). The revelation of the $64.8 billion Madoff Ponzi scheme has done more to damage the world's view of the American securities markets – and the SEC – than any other event in history. We are living in a time when our government's failure to regulate the unmitigated greed of Wall Street has caused a global economic collapse.

As a result of the SEC's stamp of approval on Madoff in 1992 and thereafter, tens of thousands of innocent Americans have lost their lives' savings. The world is now waiting to see if the American government deals responsibly with the victims of this disaster. The victims are waiting as well. To date, the SEC and Congress have not responded at all, while the Securities Investor Protection Corporation ("SIPC") has grossly misconstrued the Securities Investor Protection Act ("SIPA") for the economic benefit of Wall Street and to the extreme detriment of investors.

I personally lost all of my savings in Madoff. The firm was recommended to me by a friend in 2004 who showed me his brokerage statements which indicated that Madoff went into the market five-six times a year and purchased a portfolio of Fortune 100 company stocks; held the stocks for about a month and then sold them and put the funds in US Treasury securities. Madoff protected against market volatility by buying

put and call options. The strategy looked safe and conservative. I told my friend the only risk was that Madoff was a fraud. My friend laughed and said that Madoff had an impeccable reputation in the industry, had been Chairman of the NASDAQ, and that firms who were jealous of his trading strategy had reported him to the SEC who had investigated Madoff on several occasions and found him to be absolutely honest. Naively, I thought there could be no better recommendation.

Whether the SEC's placement of a stamp of approval on Madoff from 1992 on, despite repeated clear indicia of gross impropriety, was the result of utter incompetence or of something worse, the SEC must accept responsibility for the massive losses to innocent people of their lives' savings and assure that SIPC acts consistently with SIPA to fulfill investors' "legitimate expectations" that the balances shown on their brokerage statements belonged to them. In this letter, I ask that the SEC take the following actions:

1. The SEC should immediately intercede to require SIPC to fulfill its statutory obligations to promptly pay all customer claims and to allow those claims at the amounts required by SIPA, *i.e.*, inclusive of "fictitious" income since customers had a legitimate expectation that the securities listed on their customer statements belonged to them. Four months after Madoff's confession, SIPC, to my knowledge, has paid only 15 claims. This is a national disgrace.

2. The SEC should support a cost-of-living increase in SIPC insurance (fixed in 1978 at $500,000) to $1.6 million. This increased coverage should be available to Madoff victims. Wall Street must be forced to police itself. If broker-dealers had to pay the victims of Ponzi schemes, they would not sit by quietly and allow them to continue with impunity. There were a number of Wall Street firms that announced, shortly after December 11, 2008, that they were never fooled by Madoff. Yet, in the almost 30 years of Madoff's illegal operations, they never came forward. If they had to foot the bill for the disaster, they would police their own industry.

3. The SEC should propose an amendment to the Bankruptcy Code to prohibit "claw back" (preference and fraudulent conveyance) litigation against innocent

customers of an SEC-regulated broker-dealer. These customers, and the financial institutions that finance them, have a right to rely upon the balances shown on their brokerage statements. To permit innocent victims to have money "clawed back" after having already lost their lives' savings is double victimization.

The SEC has an obligation to assure that SIPC fulfills its statutory obligations to Madoff investors

The detailed, comprehensive reports delivered to the SEC by Harry Markopolos, which accurately laid out Madoff's scheme, are well known to you, I am sure. However, long before Harry Markopolos wrote to the SEC, the SEC had closed down one of Madoff's early feeder funds. On November 17, 1992, the SEC had charged Frank J. Avellino and Michael S. Bienes with operating an unregistered investment company that managed $441 million. Their business was closed down because they didn't register the promissory notes they gave their investors as securities. The SEC's complaint charged that the money collected from investors was turned over to an un-named broker-dealer who managed the accounts at his own discretion, purportedly putting the investments into listed stocks.

According to a December 1, 1992 article in the Wall Street Journal ("WSJ"), "[n]one of the officials involved in the case would disclose the name of the broker-dealer whose trading apparently produced results good enough to draw in such a large sum of money." However, again according to the WSJ, Martin Kuperberg, SEC Senior Associate Regional Administrator in NY, "said that the returns appeared to have been generated legitimately. **"Right now, there's nothing to indicate fraud,"** he said. See Exh. 1. Any reader of this statement would reasonably have assumed that Kuperberg would not issue such a statement unless the SEC had investigated the un-named broker-dealer.

Although the SEC refused to disclose Madoff's identity as the broker-dealer servicing the accounts for Avelino and Bienes, Madoff's identity was disclosed two weeks later in a December 16, 1992 article in the WSJ:

> Who was the broker with the Midas touch? The SEC, which last month went to court to shut down the operation, won't say. . . . But the mystery broker turns out to be none other than Bernard L. Madoff – a highly successful and controversial figure on Wall Street, but until now not known as an ace money manager.

See Exh. 2.

Of course, we now know, as a result of Madoff's March 12, 2009 plea, that he started his Ponzi scheme in "at least as early as the 1980's and that he never bought stocks for his customers.[1] Yet, SEC official Kuperberg had announced to the world that there was "nothing to indicate fraud" on the part of Madoff. On what basis did Kuperberg make that statement? If the SEC had simply demanded that Madoff produce the documentary evidence of its money management for Avelino and Bienes in 1992, the SEC would have discovered that Madoff never bought securities for his clients and his Ponzi scheme would have been exposed and terminated at that time.

SIPC has violated its statutory obligations

The devastation caused by the Madoff Ponzi scheme could easily have stripped 200,000 people of their lives' savings. The full demographics of Madoff's victims are unknown. Irving Picard, the SIPC Trustee, can certainly provide to you the number of active accounts Madoff had as of December 11, 2008. However, those accounts consisted of (a) direct investors; (b) investors through partnerships or LLC's formed by groups of family members or friends who, alone, could not meet Madoff's minimum

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[1] In the allocution that Mr. Madoff read in court on March 12, 2009, he stated that the Ponzi scheme began in the early '90's. However, in response to a question from Judge Chin, Mr. Madoff acknowledged that the government's Information was accurate. The Information alleged that the Ponzi scheme began "at least as early as the 1980's."

investment requirements; (c) investors through feeder funds, including IRA's, 401-K's, and pension funds of which hundreds or thousands of company employees could have been beneficiaries; (d) investors through feeder funds which drew on foreign investment funds and foreign banks; and (e) charities, universities, and foundations, some of which lost their entire endowment.

(a) SIPC has failed to promptly pay customers' claims

The most immediate need for the SEC's intervention is the utter failure of SIPC and its trustee, Irving Picard, to provide immediate payment of SIPC insurance to the Madoff investors. Many of these investors are elderly people who were entirely dependent upon their Madoff investments for their daily expenses. When that funding was cut off in December 2008, these people had literally no ability to buy food or pay for shelter. Many have been forced into nursing homes; many have been forced to try to sell their homes at fire-sale prices, simply so that they do not have to go on welfare.

Despite the catastrophic consequences for so many innocent Americans and despite the fact that SIPC is statutorily mandated to "promptly satisfy all obligations of the member to each of its customers," 15 U.S.C. Section 78fff-4(c), so far as I know **SIPC has, to date, paid SIPC insurance to only 15 investors** – despite the fact that thousands of investors have filed claims.

(b) SIPC has deliberately mis-interpreted "net equity"

SIPC insurance is $500,000 per account for securities and $100,000 per account for cash – amounts that have not been changed since 1978 despite the fact that the cost of living has tripled in that period. SIPC has charged broker-dealers a mere $150 per year for SIPC insurance. Thus, firms like Goldman Sachs have paid $150 per year for the privilege of printing on every trade confirmation that the customer's account is insured by $500,000 of SIPC insurance.

Given the paltry fee that SIPC has charged brokers and dealers for this insurance coverage, SIPC does not have sufficient funds to honor its contractual obligations to the Madoff victims. **Therefore, SIPC has decided to construe its insurance obligation in such a way as to deprive the vast majority of Madoff investors of any coverage.**

SIPC has done this by creating an entirely new – and insupportable – definition of "net equity." The SIPA trustee is required to "satisfy net equity claims of customers" of the failed broker-dealer. 15 U.S.C. Section 78fff(a)(1)(A)-(B). According to Mr. Picard, a Madoff customer's "net equity" is determined by taking the total amount the customer has invested in Madoff and reducing that sum by the total amount the customer has withdrawn from Madoff while entirely ignoring the appreciation in the customer's account over the 20-25 years the customer may have had his Madoff account.

Mr. Picard's convenient definition is directly contrary to SIPA which requires that the customer's "net equity" be determined by taking the balance in the customer's account as of the customer's last statement and reducing it by any funds owed by the customer to the broker. See 15 U.S.C. Section 78lll(11). *See also, In re New Times Securities Services, Inc.*, 371 F. 3d 68, 72 (2d Cir. 2004)("Each customer's "net equity" is "the dollar amount of the account or accounts of a customer, to be determined by calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer" corrected for "any indebtedness of such customer to the debtor on the filing date.").

SIPC's position is directly contradicted by a statement that SIPC's general counsel, Josephine Wang, gave to the press on December 16, 2008 wherein Ms. Wang acknowledged that a Madoff customer is entitled to the securities in his account:

> Based on a conversation with the SIPC general counsel, Josephine Wang, if clients were presented statements and had reason to believe that the securities were in fact owned, the SIPC will be required to buy these securities in the open market to make the customer whole up to $500K each. So if Madoff client number 1234 was given a statement showing

> that they owned 1000 GOOG shares, even if a transaction never took place, the SIPC has to buy and replace the 1000 GOOG shares.

See Exh. 3.

If SIPC had acted in accordance with its general counsel's statement that SIPC would replace the shares in each Madoff customers' account as of November 2008 up to $500,000, every Madoff customer would have received securities worth $500,000 or a check for $500,000. That has not occurred because of Mr. Picard's inventive definition of "net equity."

SIPC's position is also directly contrary to the position it took in the 2002 Ponzi scheme case, New Times Securities Services, Inc., where SIPC elected to provide investors with substitute securities. There, SIPC recognized its obligation to allow "that portion of the mutual fund investors' claims that represent shares of such mutual funds purchased by them **through dividend reinvestment.**" See Exh. 4 hereto at 7, fn. 5; emphasis added. **Thus, the trustee in that case paid SIPC insurance based on the customers' final statements, which included dividend reinvestment, and thereby fulfilled the customers' legitimate expectations.**

SIPC's position is also inconsistent with the Internal Revenue Code and with Rev. Proc. 2009-20, recently issued by IRS Commissioner Shulman, which expressly recognizes the income earned by investors on their Madoff investments and the billions of dollars of taxes that Madoff investors paid to the Internal Revenue Service on phantom income over the last 20-30 years.

The practical effect of SIPC's self-serving interpretation of "net equity" is that SIPC will not pay any money to thousands of people who invested with Madoff in the 1980's and 1990's, whose accounts appreciated substantially and who, after retirement, drew out funds annually to pay taxes on their "phantom" income (at short term capital gains rates), to support themselves, and to satisfy the mandatory withdrawal obligations of their IRA's.

By ignoring the statute's mandate to credit customers with the appreciated balances in their accounts, SIPC does not have to assess its members for any additional funds to compensate Madoff investors in accordance with SIPA's requirements. At the same time, of course, **SIPC is destroying the legitimate expectations of Madoff's customers that the balances shown on their monthly statements represented their assets.** [2]

Surely, this is not the time in our history for SIPC to add to America's disgrace by further enriching Wall Street at the expense of Main Street. Surely, there is no more essential means of re-building the world's confidence in the American securities markets than by recognizing a customer's **legitimate expectation** that the balance on his monthly statement belongs to him.

(c) The SEC has the responsibility to challenge SIPC's interpretation

The Supreme Court held that SIPA invests the SEC with plenary authority to supervise SIPC. *Securities Investor Protection Corporation v. Barbour,* 421 U.S. 412, 417 (1975). As noted by the Second Circuit in the *New Times* case, Congress clearly intended for the SEC to provide "substantial oversight" over the "conduct of the affairs of SIPC." SEC. H.R. Rep. NO. 91-1613, at 11-12 (1970), reprinted in 1970 U.S.C.C.A.N. 5254, 5265. Indeed, the House Committee on Interstate and Foreign Commerce indicated that it "not only directs, but expects the Commission to use oversight in a vigorous, but fair, manner." *Id.* at 5266.

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[2] *See, e.g.,* SIPC's Series 500 Rules, 17 C.F.R. 300.500, which provide for the classification of claims in accordance with the "legitimate expectations" of a customer based upon the written transaction confirmations sent by the broker-dealer to the customer. *See also,* 53 F.R. 10368, 1988 WL 263894, Rules of the Securities Investor Protection Corporation (March 31, 1988)(Commission order approving SIPC's Series 500 Rules, agreeing with SIPC that rules will give full effect to the Congressional intent to "satisfy the customers' legitimate expectations."(quoting S. Rep. No. 905-763 at 2.95th Cong. 2d Sess. (April 25, 1978).

In the *New Times Securities* case, the Second Circuit asked the SEC to submit an *amicus* brief with respect to SIPC's position that customers of a broker who operated a Ponzi scheme and, like Madoff, never purchased securities, were entitled to only $100,000 of SIPC insurance (instead of $500,000) since they had no securities in their accounts. The customers whose claims were the subject of the appeal had received trade confirmations indicating the purchase of investments in non-existent mutual funds. **Nevertheless, the SEC took a position adverse to SIPC and agreed with the customers that they were entitled to $500,000 of SIPC insurance because they legitimately expected that they owned securities, regardless of the fact that the broker had never purchased the securities.**

However, the SEC agreed with SIPC that, unlike the *New Times* customers whose trade confirmations indicated the purchase of investments in real securities (whose claims SIPC honored at the amount shown on their last statements), with respect to customers who held non-existent securities in their accounts, the amount of their customer claims should exclude any appreciated amounts. The rationale for this holding was that a customer that purportedly owned non-existent securities could not have legitimately expected any appreciation since the customer could not have verified any appreciated amount. The Second Circuit noted:

> As the SEC indicated in its brief, basing customer recoveries on "fictitious amounts in the firm's books and records would allow customers to recover arbitrary amounts that necessarily have no relation to reality . . . [and] leaves the SIPC fund unacceptably exposed."

371 F. 3d 68, 88 (2d Cir. 2004).

Of course, in Madoff, all of the customer confirmations indicated the ownership of securities in Fortune 100 corporations and customers could easily check the purchase and sale prices of these securities. Thus, the balances shown on customer statements bore a direct relationship to the appreciation in their accounts through the purchase and sale of

known securities. **For this reason, the Madoff investors are entitled under SIPA to customer claims in the amount shown as their balance as of November 2008.** [3]

SIPC and Trustee Picard have taken the position that no Madoff investor who has taken more money out than he has put in (over the course of 20-30 years) is entitled to any SIPC coverage, no matter how much his November 2008 statement indicated his assets in Madoff were. Thus, SIPC is refusing to pay insurance to a huge number of long-time Madoff investors whose November 2008 balances showed millions of dollars in assets. **Given the extreme devastation that Madoff victims are suffering, I ask that you intercede with SIPC to assure that SIPC honors customer claims immediately.** It would only extend the calamity for innocent investors to have to wait years for this issue to be resolved in their favor through the court system.

SIPC insurance should be increased to $1.6 million

In 1970, Senator Edward S. Muskie proclaimed, in urging the prompt enactment of SIPA: "after this bill is enacted, no American will lose his savings through a brokerage firm bankruptcy."[4] SIPC insurance was fixed in 1978 at $500,000 and has never been adjusted for the enormous cost of living increase in the past 30 years. If the insurance were adjusted in accordance with the increase in the cost of living, investors would be entitled to $1.6 million of SIPC insurance. It is in our national interest for this adjustment to be made, effective so as to increase the insurance for Madoff investors.

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[3] In the *New Times* SIPC proceeding, 900 claims were filed of which 726 customers had confirmations showing real securities that were never purchased and 174 customers had confirmations showing fictitious securities that were never purchased. SIPC honored the 726 customers' claims, crediting those customers with the appreciation shown in their accounts. It was only the customers whose confirmations showed fictitious securities whose claims were limited to the amounts they had invested.

[4] Federal Broker Dealer Ins. Corp.: Hearing on S2388, 3988 and 3989 before the Subcommittee on Securities of the Senate Com. on Banking and Currency, 95th Congress Cog. 10(1970) at 147.

Brokers and dealers are in the best position to police illegal securities operations. It is absolutely preposterous that Goldman Sachs has paid a mere $150 a year for SIPC insurance. If Wall Street firms were responsible for the losses of Ponzi scheme victims, they would diligently police their industry and protect investors. As a matter of public policy, this would be a crucial step in restoring confidence in the SEC and in the American securities markets.

The SEC should advocate an amendment to the Bankruptcy Code to prohibit clawbacks from innocent investors

Trustee Picard has announced that he intends to "claw back" pursuant to the avoidance provisions of the Bankruptcy Code payments of income that were made by Madoff to investors over the past six years. Investors withdrew income from their accounts at Madoff to support themselves and their families, to pay short-term capital gains taxes on their Madoff income, and to take the mandatory withdrawals from their IRA accounts.

It is totally inconsistent with the purposes and provisions of SIPA to sue innocent investors who received payments from Madoff out of their accounts. I therefore respectfully request that you put the SEC's recommendation behind an amendment to the Bankruptcy Code, which would provide as follows:

> Notwithstanding the provisions of Sections 544, 547 and 548 of this title, no action shall be brought by a SIPC trustee against any customer of an SEC-regulated broker-dealer seeking the recovery of assets in that customer's account, absent a showing that the customer participated in some illegal transaction with the broker-dealer.

SIPA supersedes the Bankruptcy Code where the provisions of the Code are inconsistent with SIPA. 15 U.S.C. § 78fff(b). The underlying purpose of SIPA is to satisfy the "legitimate expectations" of customers of an SEC-regulated broker-dealer. Such a customer has a legitimate expectation that the balance shown on his brokerage

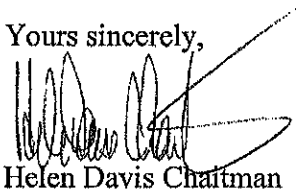
statement is his asset. Similarly, the bank from which he borrows money has a right to rely upon the balance shown on the borrower's brokerage statement when making decisions with respect to credit.

The proposed amendment is, thus, absolutely essential in order to restore confidence in the American securities markets. The lives of many long-time Madoff investors are being destroyed by the fear that the meager funds they have left (from the sale of their residences, their furniture, and their jewelry) will be taken away from them by Trustee Picard as he claws back money they took out of Madoff over the years to pay their taxes and to support themselves. No innocent investor should have to worry that, at some point in the future, his assets could be "clawed back" by a bankruptcy trustee.

As a key figure in the Obama administration, I hope that you will accept responsibility to work with the Madoff victims to correct the Trustee's misinterpretation of "net equity," expedite the SIPC payments, and help restore America's confidence that the SEC can be an effective watchdog for the individual investor.

Thank you very much for your consideration of the issues raised in this letter. I would very much appreciate the opportunity to meet with you and your staff to discuss how the concerns of hundreds of Madoff investors can be resolved. I have a number of suggestions for ways that the SEC can prevent such catastrophes in the future. As time is of the essence to many victims, I look forward to hearing from you as soon as possible.

Yours sincerely,



Helen Davis Chaitman

HDC:leb

cc: Irving Picard, Esq.
David Sheehan, Esq.

EXHIBIT 1

SEC Breaks Up Investment Company That Paid Off Big but Didn't Register

By Randall Smith, Staff Reporter [Wall Street Journal 12/1/92]

Two Florida accountants have returned $441 million to investors after regulators charged them with a huge sale of unregistered securities, their lawyer said.

The two accountants, Frank J. Avellino and Michael S. Bienes of Fort Lauderdale, promised, and apparently delivered, annual returns of 13.5% to 20% to their investors. Their main office is located in New York City.

However, in a complaint filed Nov. 17 in federal Court in Manhattan, the Securities and Exchange Commission charged the two men with operating an unregistered investment company because they didn't register as securities the promissory notes they gave their investors.

Investments in Stocks

The SEC complaint said the money collected from investors was turned over to an. unnamed broker-dealer, who managed the accounts at his own discretion. One person familiar with the case said the broker put the money into listed stocks. The complaint said Messrs. Avellino and Bienes kept the difference between the fixed interest they paid to investors and the returns generated by the broker's investment decisions.

In an announcement, the law firm for the two accountants, Squadron, Ellenoff, Plesent & Lehrer, said the partnership of Avellino & Bienes is dissolving and had returned all principal and interest due its noteholders as of Nov. 16. Ira Lee Sorkin, a partner in the law firm, said the return was completed Nov. 24.
The SEC said the two men ended their 22-year-old accounting practice and began focusing exclusively on their more-profitable investing business in 1984. Although 13.5% to 20% rates of return are high by historical standards, they wouldn't have been impossible to attain. For example, from Jan. 1, 1984, to Oct. 31, 1992, the Vanguard Group stock index fund showed a 14.85% annual return, according to Morningstar Inc., a mutual fund data service.

As of Oct. 30, the SEC said the two men had nine different trading accounts with the broker-dealer with an equity value of $454 million. At the same time, they had issued notes totaling, $441 million either through new sales to investors or the rollover of interest payments.

Martin Kuperberg, SEC senior associate regional administrator in New20York, said, "The investing public must get the protection afforded by the federal securities laws, such as a prospectus, certified reports, and fidelity bonds." However, Mr. Sorkin said his clients didn't know they were subject to such requirements.

'Nothing to Indicate Fraud'
None of the officials involved in the case would disclose the name of the broker-dealer whose trading apparently produced results good enough to draw in such a large sum of money. However, Mr. Kuperberg said that the returns appeared to have been generated legitimately "Right now, there's nothing to indicate fraud," he said.

Neither Mr. Avellino nor Mr. Bienes, both 56 years old, were available to comment, according to their New York office. Mr. Sorkin characterized the sales of unregistered securities as "technical violations."

The investors' money was ordered returned by federal judge Kenneth Conboy, who named New York attorney Lee Richards as trustee. Mr. Richards, in turn, has hired the accounting firm of Price Water-house & Co. to audit the partnership's financial records.

EXHIBIT 2

The Wall Street Journal
December 16, 1992

Wall Street Mystery Features a Big Board Rival

By RANDALL SMITH

This article was published in the Dec. 16, 1992, edition of The Wall Street Journal.

Here's a tantalizing Wall Street mystery:

The Securities and Exchange Commission recently cracked down on one of the largest-ever sales of unregistered securities. Investors had poured $440 million into investment pools raised by two Florida accountants, who for more than a decade took in money without telling the SEC or making required financial disclosures to investors.

The pair had promised investors hard-to-believe annual returns of 13.5% to 20% -- to be obtained by turning the money over to be managed by an unnamed broker.

Regulators feared it all might be just a huge scam. "We went into this thinking it could be a major catastrophe," says Richard Walker, the SEC's New York regional administrator.

But when a court-appointed trustee went in, the money was all there. Indeed, the mystery money manager was beating the promised returns by such a wide margin that the two accountants ditched their accounting business in 1984 to concentrate on their more lucrative investing sideline.

Who was the broker with the Midas touch? The SEC, which last month went to court to shut down the operation, won't say. Neither will the lawyer for the two accountants, Frank J. Avellino and Michael S. Bienes of Fort Lauderdale.

But the mystery broker turns out to be none other than Bernard L. Madoff -- a highly successful and controversial figure on Wall Street, but until now not known as an ace money manager.

Mr. Madoff is one of the masters of the off-exchange "third market" and the bane of the New York Stock Exchange. He has built a highly profitable securities firm, Bernard L. Madoff Investment Securities, which siphons a huge volume of stock trades away from the Big Board. The $740 million average daily volume of trades executed electronically by the Madoff firm off the exchange equals 9% of the New York exchange's.

Mr. Madoff's firm can execute trades so quickly and cheaply that it actually pays other brokerage firms a penny a share to execute their customers' orders, profiting from the spread between bid and asked prices that most stocks trade for.

In an interview, the 54-year-old Mr. Madoff says he didn't know the money he was managing had been raised illegally. And he insists the returns were really nothing special, given that the Standard & Poor's 500-stock index generated an average annual return of 16.3% between November 1982 and November 1992. "I would be surprised if anybody thought that matching the S&P over 10 years was anything outstanding," he says.

In fact, most investors would have been delighted to be promised such returns in advance, as the accountants' investors were. That's especially true since the majority of money managers actually trailed the S&P 500 during the 1980s.

The best evidence that the returns were very attractive: the size of the pools mushroomed by word-of-mouth, without any big marketing effort by the Avellino & Bienes artnership. The number of investors eventually grew to 3,200 in nine accounts with the Madoff firm. "They took in nearly a half a billion dollars in customer money totally outside the system that we can monitor and regulate," says the SEC's Mr. Walker. "That's pretty frightening."

An SEC civil complaint filed in New York federal court Nov. 17 charged that Messrs. Avellino and Bienes "have operated A&B as an unregistered investment company and have engaged in the unlawful sale of unregistered securities," and ordered the money returned to investors by a court-appointed trustee, New York attorney Lee Richards.

The two 56-year-old accountants declined to comment. Their attorney, Ira Lee Sorkin, says they didn't know that the notes they had issued to their clients should have been registered with the SEC, and he says that investors got their money back and haven't complained.

If the notes had been registered, they would have had to include a description of how the money was being invested, and by whom. In addition, Avellino & Bienes would have had to send investors annual reports and financial statements.

But how did Mr. Madoff rack up his big investment returns? Early investors in the late 1970s were told -- and Mr. Madoff confirms -- that their money was being used to engage in so-called convertible arbitrage in securities of such companies as Occidental Petroleum Corp., Limited Stores Inc. and Continental Corp. Promised annual returns in this period, one investor said, were 18% to 20%. In such a strategy, an investor buys a company's preferred stock or bonds that pay high dividends and are convertible into the company's common stock; the investor simultaneously sells borrowed common stock of the same company in a "short sale" to hedge against a stock-price decline.

The investor earns the spread between the higher dividend paid on the convertible securities and the lower dividend on the common stock, plus interest from investing the proceeds of the stock short sale. Using borrowed money, or leverage, to magnify returns, an investor can reap double-digit returns. But the strategy carries big risks if interest rates rise and stock prices go down.

Mr. Madoff said his investment strategy changed around 1982, when his firm began using a greater variety of strategies tied to the stock market, including the use of stock-index futures and "market-neutral" arbitrage, which can involve buying and selling different stocks in an industry group.

Mr. Madoff said, "The basic strategy was to be long a broad-based portfolio of S&P securities and hedged with derivatives," such as futures and options. Such a strategy, he said, allowed the investors "to participate in an upward market move while having limited downside risk." For example, he said, the Madoff firm made money when the stock market crashed in 1987 by owning stock-market index puts, which rose in value as the market declined.

In the mid-1980s, one investor says, the limited reports that Avellino & Bienes sent to investors changed, and investors stopped being told in which securities their money was invested. The interest rate on some new notes sold by the accountants was also lowered to 16% or less. One investor who complained about the vaguer reports and lower returns was told that if he didn't like them, he could withdraw his investment. He chose to remain.

Perhaps the biggest question is how the investment pools could promise to pay high interest rates on a steady annual basis, even though annual returns on stocks fluctuate drastically. In 1984 and 1991, for example, the stock market delivered a negative return, even after counting dividends. Yet Avellino & Bienes -- and Mr. Madoff -- maintained their double-digit returns.

The answer could be that Mr. Madoff's use of futures and options helped cushion the returns against the market's ups and downs. Mr. Madoff says he made up for the cost of the hedges -- which could have caused him to trail the stock market's returns -- with stock-picking and market timing.

Certainly, the investment pools' returns were less astounding by the standards of the early 1980s, when short-term interest rates briefly topped 20%. But the annual returns on Treasury bills hit a peak of 14.7% in 1981, and remained under 12% in the three other years that bills had double-digit returns, 1979-82, before falling later in the '80s.

One person familiar with the Avellino & Bienes case speculated that having the assets of the investment pools under management may have helped Mr. Madoff's firm by giving him an inventory of securities that could help him to execute other trades for his firm. Not true, said Mr. Madoff: "One thing has nothing to do with another."

As the investment pools swelled, two other accountants, Steven Mendelow of New York City and Edward Glantz of Lake Worth, Fla., started their own pool, Telfran Ltd., to invest in Avellino & Bienes notes. Telfran by itself sold $89.6 million in unregistered notes, a separate SEC civil lawsuit charges. The two men, also represented by Mr. Sorkin, declined to comment. The SEC said Telfran made money by investing in

Avellino & Bienes notes paying 15% to 19% annually, while paying Telfran investors lower rates.

All the while, Mr. Madoff was scoring investment returns that comfortably exceeded the hefty returns Avellino & Bienes was promising its noteholders. That excess return generated big profits for the two accountants, the SEC suit indicates. The SEC has asked that those profits be returned as "unjust enrichment," a demand Mr. Sorkin calls "totally unwarranted." For his part, Mr. Madoff says he charged the investment pools only what he described as standard brokerage commissions. He termed turnover in the accounts "not very active," almost nil in some years.

EXHIBIT 3

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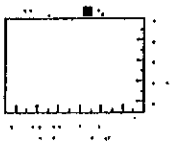

Insiders' Blog

SIPC's Role In Madoff-Of-All-Scams Could Save The Stock Market

December 16, 2008 2:14 PM EST

Could the Bernard Madoff fraud actually help the stock market?

The SIPC came out with a statement last night indicating that they will be involved in the Madoff situation. The SIPC maintains a special reserve fund authorized by Congress to help investors at failed brokerage firms. The SIPC reserves are available to satisfy the remaining claims of each customer up to a maximum of $500,000, including a maximum of $100,000 for cash.

It seems likely that most, if not all, of the statements Bernard Madoff delivered to clients were entirely bogus. Based on the SIPC mandate, it could be in the realm of possibility that the *SIPC has to buy securities* to replace those that were faked on statements delivered to Madoff clients.

Based on a conversations with the SIPC general counsel Josephine Wang, if clients were presented statements and had reason to believe that the securities were in fact owned, the SIPC will be required to buy these securities in the open market to make the customer whole up to $500K each. So if Maddof client number 1234 was given a statement showing that they owned 1000 GOOG shares, even if a transaction never took place, the SIPC has to buy and replace the 1000 GOOG shares.

Imagine $50 billion in net buying to the stock market, on behalf of the SIPC, to replace client's stocks that were never bought? While this likely won't happen to this extent, it is in the realm of possibility.

Ms. Wang indicated to us that the SIPC has a budget of just $1.6 billion and a few credit lines worth $2 billion total. While SIPC is a non-profit organization, they have indicated to us that they will try to make as many people as whole as possible. They claim to be free from any conflicts of interest, even if the amount needed would eclipse their budget. When asked if the Madoff claims came in at $5 billion what would be done, Ms. Wang indicated to us that they could look to Congress for the money.

The SIPC said their involvement with the Madoff case strictly involves the broker-dealer. So, one of the main issues the SIPC trustee appointed to the Madoff case will have to address is how Madoff hedge fund clients and other investment management clients will be dealt with. Will they be protected? Also, if a hedge fund that invested in Madoff has 100 clients, will the SIPC pay out $500K just to the hedge fund or $500K to each of the 100 clients?

There are many questions that are still unanswered on the massive Bernie Madoff ponzi scheme, but it would be ironic if the biggest scam in history, that has hurt so many people, turned out to be a slight positive to the market. Our prayers are with all of those who have lost money having faith in Madoff and the system that has failed us.

Stocks Mentioned

Related Entities

- Hedge Funds
- Bernard Madoff

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Comments

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MS Wang

Audrey on Mar 29, 2009 03:59 PM

It is absolutely essential that we clarify Ms. Wang's position and then find out who Ms. Wang has to account to. For those who do not realize it, the SEC sanctioned Madoff several times and thus failed to protect the investors against fraud. The tax laws only go back 5 years.

Josephine Wang

Ronnie Sue Ambrosino on Mar 29, 2009 03:41 AM

It is my understanding that Ms. Wang is now denying the fact "if clients were presented statements and had reason to believe that the securities were in fact owned, the SIPC will be required to buy these securities in the open market to make the customer whole up to $500K each. So if Maddof client number 1234 was given a statement showing that they owned 1000 GOOG shares, even if a transaction never took place, the SIPC has to buy and replace the 1000 GOOG shares." Can the author of the article clarify this confusion for more than 8000 investors who received SIPC claim forms? Please send to: info@bernardmadoffvictims.org

WHERE IS THE MONEY?

JOANNE on Jan 6, 2009 02:57 PM

What could have happened to all this money he took? I am sure not all of it went to pay dividends/interest? They should sieze all his assets, sell them and divide amoungst the people let out in the cold. I realize that people were taken by him, but also, they were a little greedy. Something too good to be true usually is.

Institutional Investors?

Benito M on Dec 22, 2008 03:18 PM

Can anybody explained how "sophisticated" institutional types like HSBC and Santander were dupped by this Madoff Scheme? We have to rename this scheme. Were the credit risk management team on holiday during this endeavor. This whole "staged event", in light of Robert Rubins looting of twice as many sheckels, seems very suspicious. Gee, Robert Rubin is amongst the Obama team. You better wake up Amerika! The depth of this kosher mafia is in ALL aspects of american society!!! http://iamthewitness.com/news/2008.12.18-The.Madoff.Double-Bluff.html

Madoff and SIPC

Thomas Mullooly on Dec 19, 2008 10:50 PM

The purpose of the SIPC is to protect investors who have been damaged due to a brokerage failure...NOT fraud. Sadly, the SIPC is not designed for this situation. These losses are from theft, not from a brokerage failure. There are tax laws designed to allow write-off for nearly every dollar lost due to theft. This would ultimately be more valuable to investors than getting a potential $500,000 back (whenever that may or may not happen) versus multi-million dollar losses.

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EXHIBIT 4

[illegible]
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(516) 227-0700

3/28
22 ORIGINAL

Sigmund S. Wissner-Gross (SW-0001)
May Orenstein (MO-2948)
HELLER, HOROWITZ & FEIT, P.C.
292 Madison Avenue
New York, New York 10017
(212) 685-7600

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

----------X

In re New Times Securities Services, Inc.

Case No. 800-8718 (SB) SIPA

Debtor.

----------X

LIMITED OBJECTION TO TRUSTEE'S DETERMINATION OF CLAIM

Claimants Simon Noveck and Helga Noveck (the "Novecks") hereby submit their limited objection to the Trustee's determination regarding a customer claim asserted by them (the "Claim") in this proceeding.

In their Claim, the Novecks assert, for reasons explained below, that they are owed $321,010.08 for purchases of shares of the New Age Securities Money Market Fund ("NASMMF"). In his March 2, 2001 determination with respect to the Claim, the Trustee advised that, while the Novecks had deposited $300,000.00 for the purchase of shares of NASMMF, the Trustee will pay (or satisfy) the claim only to the extent of $100,000. (A copy of the Novecks' Claim is annexed as Exhibit A hereto; a copy of the Trustee's determination is annexed as Exhibit B hereto).

As explained below, the Novecks are entitled to have their claim satisfied in the amount of $321,010.08, which is the value of their "net equity" claim for shares of NASMMF held for their account by the Debtor. The Trustee's determination here is contrary to applicable

Exhibit A | Exhibit B | Exhibit C

[illegible] in this proceeding and is equitable and [illegible]

The Novecks respectfully represent as follows:

BACKGROUND

1. On February 17, 2000, the United States Securities and Exchange Commission ("SEC") filed a Complaint (the "SEC Complaint") in the United States District Court for the Eastern District of New York (the "District Court") against William Goren ("Goren"), New Age Financial Services, Inc. ("New Age") and New Times Securities Services, Inc. ("NTSSI"). The SEC Complaint alleges that Goren conducted a long-running "ponzi" scheme, defrauding hundreds of investors and causing investor losses currently estimated by the SEC at $32.7 million. NTSSI was named as a relief defendant in the SEC action, *inter alia*, because of its receipt of transfers from the New Age "ponzi" scheme account at Fleet Bank of not less than $1,243,000 in 1998 and $340,000 in 1999. On March 9, 2001, Goren, who had pled guilty to his criminal conduct, was sentenced to a prison term of 87 months for his role in the "ponzi" scheme.

2. By application, dated May 16, 2000, to the District Court, the Securities Investor Protection Corporation ("SIPC") sought the issuance of a Protective Decree adjudicating that the customers of NTSSI were in need of the protection afforded by the Securities Investor Protection Act of 1970 ("SIPA"). By Order of the District Court, (i) all proceedings relating to NTSSI were transferred to this Court; (ii) NTSSI was placed into liquidation; and (iii) James W. Giddens, Esq. of Hughes Hubbard & Reed LLP was appointed as Trustee for the liquidation of NTSSI.

3. By motion, dated November 6, 2000, the Trustee sought an order substantively consolidating the NTSSI and New Age estates. The District Court subsequently authorized the Receiver for New Age to consent to the Trustee's substantive consolidation motion, and this Court approved the Trustee's motion and entered an Order, dated November 27, 2000 (the

[illegible] consolidating these estates. Pursuant to the Consolidation Order, [illegible] liabilities for NTSSI and New Age are to be pooled, all intercompany liabilities, guarantees and claims are to be cancelled, and the combined estate is to be administered by the Trustee in accordance with SIPA and the Bankruptcy Code under the jurisdiction of this Court.

4. Pursuant to the Consolidation Order, for purposes of determining "customer" claims under SIPA, the "Debtor" includes NTSSI and New Age for claims arising after April 19, 1995, the date that, according to the Trustee, NTSSI became an SEC registered broker-dealer and SIPC member. The consolidated entities are referred to herein collectively as the "Debtor".

THE CLAIM

5. Simon and Helga Noveck reside in Flushing, Queens, New York. Simon Noveck is 80 years old, in extremely poor health, and disabled.[1] Both Simon Noveck and Helga Noveck are retired. After coming to the United States after World War II, Simon and Helga both worked, living modestly, and Simon Noveck ultimately managed to start his own small business, designing, constructing, and assembling parts for printing press machines for use by newspapers.

6. After their youngest son graduated college, the Novecks finally were able to begin to save some money. Having been introduced to William Goren by Adriane Berg of WABC, who endorsed and touted investing with Goren, the Novecks began investing with Goren in September 1998. The Novecks advised Goren, consistent with the endorsement of Goren by Adriane Berg (upon which they relied), that they wanted to invest in the safest and most conservative investment available. They informed Goren of their personal circumstances; Goren knew that the Novecks were Holocaust survivors, whose life savings were the result of years of honest, hard work, and that such savings were needed for the Novecks' retirement. Goren placed

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[1] After several operations, Simon Noveck underwent a hemipelvectomy when his youngest son was 8 years old. Simon Noveck today is in most fragile health, and is only able to walk with extreme difficulty.

the Novecks to the NASMMF, which offered a fixed rate of [illegible] available at the Novecks' bank.

7. Between September 1998 and April 1999, the Novecks invested virtually their entire life savings, $300,000, with Goren, believing that they had purchased shares of the NASMMF. For each purchase, the Novecks received a confirmation. At all times, the shares of the Fund maintained a price per share of $1.00. The Novecks' investments were made as follows, on or about the following dates:

8. September 4, 1998. The Novecks invested $120,000 to purchase 120,000 shares of the NASMMF.

9. December 8, 1998. The Novecks invested $80,000 to purchase 80,000 shares of the NASMMF.

10. January 25, 1999. The Novecks invested $67,696.07 to purchase 67,696.07 shares of the NASMMF.

11. February 4, 1999. The Novecks invested $32,363.93 to purchase 32,303.93 shares of the NASMMF.[2]

12. As indicated on the Novecks' New Times Securities Corporation statements, relevant copies of which were supplied in support of their Claim and which are annexed as Exhibit C hereto, dividends on shares of NASMMF were automatically invested in additional shares of NASMMF. As reflected in the last brokerage statement received by the Novecks, as of December 31, 1999, the Novecks owned 321,010.08 shares of NASMMF, including 21,010.08 shares purchased through dividend reinvestment.

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[2] On April 7, 1999, Goren "transferred" $26,379.30 to a NTSSI account held by the Novecks to pay for the purchase of certain stocks. On or about April 15, 1999, Goren "transferred" $26,379.93 back to the Novecks' New Age Securities Corporation account. The Novecks also paid taxes for the purported dividends received in 1998 on their investments.

13. By notice dated March 2, 2001 (the "Notice"), the Trustee communicated his finding that the Novecks had deposited $300,000.00 with the Debtor for the purchase of shares of NASMMF and that the Claim, to the extent of such deposit, was a "valid customer claim." *See* Exhibit B hereto. Based upon such finding and determination, the Trustee allowed the Claim "as a claim for cash in the amount of $300,000.00." The Notice also communicated the Trustee's disallowance of the balance of the claim ($21,010.08), representing the value of shares acquired by the Novecks through dividend reinvestment. Notwithstanding the allowance of the Claim to the extent of $300,000.00, the Novecks were advised pursuant to the Notice that the Trustee will pay the claim only to the extent of $100,000. As explained in the Notice, the difference between the portion of the Claim allowed and the amount undertaken to be paid by the Trustee is based upon the application by the Trustee to the Claim of the payment limitation found in 15 U.S.C. § 78fff-3(a)(1). Such section, which applies only to a claim "for cash," limits the payment obligation of the Trustee to $100,000.

OBJECTIONS

14. The Novecks object to the Notice to the extent that it characterizes the Claim as one "for cash" rather than "for securities" and, based upon such characterization, applies the $100,000 statutory limit to the Trustee's payment obligation in respect of the Claim. Upon characterization of the Novecks' claim as one "for securities," the $500,000 statutory limit would be applicable and the Trustee would therefore be obligated to satisfy the full amount of the Novecks' claim. 15 U.S.C. § 78fff-3(a). The Novecks also object to the disallowance of that portion of their claim having a value of $21,010.08, representing shares of NASMMF purchased by them through dividend reinvestment.

[illegible] statutory customers of the [illegible] protection to the extent of their net equity.[3] 15 U.S.C. § 78lll(11) [illegible] as "the dollar amount of the account or accounts of a customer, to be determined by calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer..." *Id.* As established by the Novecks' account statements, the Novecks' net equity as of the February 17, 2000 filing date was $321,010.08 based upon ownership of 321,010.08 shares of NASMMF having a value of $1.00 per share. *See* Exhibit C hereto.

16. After receipt of a statement of claim, SIPA requires that a trustee promptly discharge "all obligations of the debtor to a customer relating to, or net equity claims based upon, securities or cash, by delivery of securities or the making of payments to or for the account of such customer." 15 U.S.C. § 78fff-2(b).

17. SIPA defines "security" broadly. 15 U.S.C. § 78lll(14). It is not disputed by the Trustee or SIPC that the statutory definition of a security covers shares of a money market fund.[4]

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[3] The Trustee has determined that the Novecks were customers of the Debtor for the purposes of SIPA and accordingly, such status is not at issue. "Customer" is statutorily defined as "any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security, or for purposes of effecting transfer. The term customer includes any person who has a claim against the debtor arising out of sales or conversions of such securities, and any person who has deposited cash with the debtor for the purpose of purchasing securities..." 15 U.S.C. § 78lll(2).

[4] Shares of money market funds have been acknowledged by SIPC to be securities within the protection of the statute. As stated by SIPC:

> Shares of money market funds, although often thought of by investors as cash, are in fact securities when such funds are organized as mutual funds. When held by a SIPC member in a customer's securities account, such fund shares are as protected as any ottheir covered security.

Publication of SIPC, "How SIPC Protects You," at page 7.

18. In the context of this proceeding, the Trustee has explained that he characterized all claims based upon purchases of shares of NASMMF, including the Novecks's Claim, as cash claims based upon the fictitious nature of NASMMF. In contrast to its classification of NASMMF claims as "cash claims," net equity claims which have been asserted by customers of the Debtor based upon account statements showing holdings of mutual funds having names conforming to, similar to or close to actual funds, are being treated by the Trustee as claims for securities.[5] Thus, in classifying claims as either "for cash" or "for securities" the Trustee is making a critical distinction between sham transactions involving sham securities — *i.e.*, the "fictional" NASMMF, shares of which never existed (but which are fungible with hundreds of other money markets) — and sham transactions involving the purported purchases of mutual funds denominated on account statements with names of actual funds *or* mutual funds with names similar or close to mutual funds which may be quoted in the newspaper, in which neither investors nor the Debtor ever acquired an interest. The Novecks, like the other victims of Goren, do not dispute the Trustee's conclusion that the NASMMF was never actually organized as a money market fund. However, at the same time, the Trustee does not dispute that the Novecks were entirely innocent of any culpability in connection with their purchase of shares of the NASMMF and concedes that the Novecks had no knowledge or suspicion of the non-existence of the NASMMF, which was confirmed to the Novecks and shown on their statements as a legitimate money market fund.

19. Although the Trustee has identified the fictitious nature of the NASMMF as determinative of the classification of the Novecks's claim as one "for cash" for the purposes of application of 15 U.S.C. §78fff-3 (a)(1), it has not specified any authority for reliance on this factor.

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[5] As a consequence of the characterization of the claims of mutual fund investors as claims for securities, the Trustee has undertaken to pay such claims to the extent of the $500,000 statutory maximum. In addition, whereas the Trustee has disallowed that portion of the claims of NASMMF investors representing shares of NASMMF purchased through dividend reinvestment, the Trustee has allowed that portion of the mutual fund investors' claims that represent shares of such mutual funds purchased by them through dividend reinvestment.

Exhibit A Exhibit B Exhibit C

It is submitted, however, that the Trustee's reliance on the [illegible] NASMMF in characterization of the Claim is contradicted by the rules adopted by SIPC for determining whether a customer claim is for cash or for securities. 17 C.F.R. §§ 300.500 - 300.503 ("Series 500 Rules").

20. Rule 501 - "Claim for Cash" provides in applicable part that:

> Where the Debtor held cash in an account for a customer, the customer has a "claim for cash," notwithstanding the fact that the customer has ordered securities purchased for the account, *unless: (1) the Debtor has sent written confirmation to the customer that the securities in question have been purchased or sold to the customer's account.*

17 C.F.R. § 300.501(b)(1) (emphasis supplied).

21. Rule 502 – "Claim for Securities," is the corollary of Rule 501 and provides that "Where the Debtor held cash in an account for a customer, the customer has a 'claim for securities' with respect to any authorized securities purchase: (i) if the Debtor has sent a written confirmation to the customer that the securities in question have been purchased for or sold to the customer's account[.]" 17 C.F.R. § 300.502.

22. Accordingly, the Series 500 Rules direct that where a customer has authorized a purchase of securities, it is the sending of a confirmation of that purchase or sale, rather than the execution of a trade, that determines whether the customer's net equity claim is for cash or securities. Here, the Notice includes the Trustee's determination that the Novecks authorized purchases of the NASMMF for their account. Moreover, it is not disputed that the Novecks received written confirmation of their initial purchase of shares, and, in the form of monthly or regular account statements, received confirmation of subsequent purchases by means of dividend reinvestment. In characterizing the Claim as one for cash, the Trustee disregards the apparent purpose and effect of the Series 500 Rules, *i.e.*, to bind the investor to and to allow the investor's reliance upon, written confirmation of his securities transactions. By apparently relying on the distinction between a fictitious money market fund and the fictitious purchase of shares of a money market fund (a distinction without substance) as the basis for the cash/securities determination, the

Trustee is substituting a criterion which is beyond the control and verification of the investor for the objective, mechanical, criteria provided by the Series 500 Rules.

23. The Trustee's misapplication of the Series 500 Rules is demonstrated within this proceeding by the disparate impact on the claims of similarly-positioned customers of the Debtor. In contrast to the NASMMF claimants, the Trustee apparently has determined that customers of the Debtor who entrusted funds to the Debtor for the purchase of shares of mutual funds with names (as denominated on customers' statements) similar or close to mutual funds which may be quoted in the newspaper, but whose transactions were never effected, will have their claims treated as claims for securities even though they never had any actual interest in the securities shown on their account statements. As a result, the Trustee is apparently allowing as valid customer claims "for securities" claims of customers who purchased shares of other non-existent mutual funds, while at the same time denying as valid customer claims "for securities" claims such as that of the Novecks for the purchase of shares of the NASMMF. There is nothing in the Series 500 Rules that suggests this result.

24. Moreover, the radically disparate and inequitable treatment of the NASMMF investors, on the one hand, and the mutual fund investors, on the other, results in undue and unseemly consequence given to the capricious and criminally motivated conduct of Goren rather than to any criterion reflected in the Series 500 Rules or pertaining either to customer conduct, losses or expectations. This disparate treatment is not, however, either required or contemplated by SIPA. Such disparate treatment flies in the face of the expressed Congressional intent for SIPA to satisfy customers' legitimate expectations. *See* S. Rep. No. 763, 95th Cong. 2d Sess. 2 (1978), reprinted in [1978] U.S. Code Cong. & Admin. News 764, 765. It is, in fact, absurd to suggest that Congress, in passing SIPA, intended for the scope of protection afforded to the investing public

[illegible]

fund sold to [illegible] never purchased by the broker.

25. Like the mutual fund investors, the NASMMF investors, including the Novecks, provided funds for the purchase of securities. As with respect to the funds provided by the mutual fund investors, no securities were ever actually purchased. Like the mutual fund investors, the NASMMF investors, including the Novecks, received confirmations of their purchases and monthly statements showing their security positions. Like the mutual fund investors, the NASMMF investors, including the Novecks, had no basis to question the representations made to them that securities had been purchased for their account and were being held for them by the Debtor. Indeed, the "legitimate expectations" of the NASMMF investors, including the Novecks, are indistinguishable in every respect from those of the mutual funds investors.

26. The equities in favor of treating the NASMMF investors no less favorably than the mutual fund investors are compelling. Like other NASMMF investors, the Novecks chose to purchase money market shares believing that such investment was the most conservative available. It is respectfully submitted that to allow a small group of victims to bear crushing financial loss, while others with indistinguishable claims and expectations receive full statutory protection, is unconscionable. The inequitably disparate treatment reflected by the Trustee's determination of their claims is not mandated by SIPA or the rules promulgated thereunder.

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[6] The inequity of the Trustee's approach to characterizing claims is highlighted by the Trustee's apparent willingness to overlook discrepancies in the names of mutual funds (some of which actually existed and others with fictitious names), or pricing information with regard to purchases of certain mutual funds, appearing on account statements of certain investors and to nonetheless recognize such claims as securities claims. As arbitrary and unfair as it would be to deny a claim merely because Goren was less than meticulous in accurately identifying the mutual fund that he fraudulently represented had been purchased by an investor, it is equally arbitrary and unfair to penalize the NASMMF investors for having been duped into purchasing sham securities.

[illegible] to the Notice be sustained and that the Court direct the Trustee to allow the full amount of their claim ($321,010.08) and to satisfy the entire amount of such claim as a claim for securities.

Dated: Uniondale, New York
March 26, 2001

FARRELL FRITZ, P.C.

By: Ted A. Berkowitz
Ted A. Berkowitz (TAB-3384)
EAB Plaza, 14th Floor
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Dated: New York, New York
March 26, 2001

HELLER, HOROWITZ & FEIT, P.C.

By: [signature]
Sigmund S. Wissner-Gross (SW-0001)
292 Madison Avenue
New York, New York 10017
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Attorneys for Claimants Simon and Helga Noveck

EXHIBIT B

May 1, 2009

David Becker, Esq.
General Counsel and Senior Policy Director
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Madoff Securities SIPA Proceeding

Dear Mr. Becker:

We write on behalf of customers of Bernard L. Madoff Investment Securities LLC ("Madoff Securities" or "Madoff"), a debtor in a proceeding under the Securities Investor Protection Act ("SIPA"), to respectfully request that the Securities and Exchange Commission ("SEC") exercise its plenary authority to supervise the Securities Investor Protection Corporation ("SIPC") with respect to one of the most important and central issues in the Madoff SIPC proceeding: the calculation of customers' net equity claims.[1]

SIPA states that a customer's net equity claim is the value of the "securities positions" in her account as of the filing date of the SIPA liquidation, less any amount the customer owes the debtor as of that date. In this case, the Madoff Trustee (the "Trustee") has taken a contrary position. He contends that the customers' net equity claims are to be determined by netting the total deposits against total withdrawals in their accounts since inception. As explained in this letter, while such a "cash in, cash out" valuation methodology can be appropriate in circumstances where the securities the broker-dealer had purportedly purchased were "fictitious" (i.e., non-existent securities that could never be purchased), it is entirely improper in circumstances where the securities purportedly purchased were "real" (i.e., actual securities that exist and could have been purchased). In taking this "cash in, cash out" netting position in the Madoff case – which involved purported purchases of "real" securities – the Trustee is advocating an approach that is contrary to (1) the statutory definition of "net equity" in SIPA, (2) the legislative history and intent of SIPA, (3) SIPC precedent, and (4) the leading Second Circuit authority on this issue.

In addition to being wrong as a matter of law, the Trustee's position raises significant policy questions. Not only would it impair the claims of thousands of Madoff Securities customers, it would also radically alter the perception of securities investors everywhere as to what SIPC protection means. The

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[1] As the Supreme Court stated in *Securities Investor Protection Corporation v. Barbour*, SIPA invests the SEC with "'plenary authority' to supervise the SIPC." 421 U.S. 412, 417 (1975) (citing SIPA's legislative history); *see also In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 77 (2d Cir. 2004) (citing SIPA's legislative history and other case law evidencing the SEC's "substantial" oversight authority with respect to SIPC).

consequence of such a changed perception would be to further erode investor confidence at a time when the securities industry and markets can least afford it.

Finally, given the July 2, 2009 bar date in this case, as well as the fact that many Madoff customers are currently in the process of considering or entering into settlements (with accompanying releases) with the Trustee based on the Trustee's incorrect statement of the law, this is an extremely time sensitive matter. Inaction on this issue will likely result in irreparable injury to hundreds, if not thousands, of customers.

1. The Trustee's View of "Net Equity" Is Directly At Odds with SIPA

SIPA defines a customer's net equity claim as the value of the customer's "securities positions" in her account, less any amount the customer owes the debtor, as of the date of the filing of the SIPA liquidation:

> "The term 'net equity' means the dollar amount of the account or accounts of a customer, to be determined by –
>
> (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer . . .; minus
>
> (B) any indebtedness of such customer to the debtor on the filing date . . ."[2]

15 U.S.C. § 78lll(11); *see also In re Adler Coleman Clearing Corp.*, 247 B.R. 51, 62 n.2 (Bankr. S.D.N.Y. 1999) ("'Net equity' is calculated as the difference between what the debtor owes the customer and what the customer owes the debtor on the date the SIPA proceeding is filed."); Madoff Securities SIPC Customer Claim Form (defining the customer's claim in terms of the cash and/or securities Madoff Securities owed to the customer and the cash and/or securities the customer owed to Madoff Securities as of December 11, 2008).

This statutory definition is clear and easily applied to the Madoff Securities liquidation. The typical Madoff customer received written trade confirmations, as well as detailed monthly account statements, reflecting the

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[2] The "indebtedness" of the customer to the debtor refers to cash or securities owed to the debtor, which is most often in the context of a customer having borrowed from the debtor on margin. *See, e.g.*, H.R. Rep. No. 95-746, at 21 (1977) (describing customers owing cash or securities to the stockbroker as "margin customers"); *Rich v. NYSE*, 522 F.2d 153, 156 (2d Cir. 1975) (noting that, under the 1970 statutory regime, when there were shortages in available securities to satisfy "net equity" claims, customers received cash for their securities "less, in the case of holders of margin accounts, amounts owed" to the broker); *In re First Street Sec. Corp.*, 34 B.R. 492, 497 (Bankr. S.D. Fla. 1983) (offsetting against claim amount of indebtedness customer owed to the debtor where unauthorized stock purchase was funded in part by borrowing on margin).

customer's "securities positions" in real and publicly verifiable securities (e.g., IBM, AT&T).[3] SIPA explicitly provides that the customer's "net equity" is the amount "owed by the debtor to [the] customer," determined by calculating what the value of the customer's "securities positions" would have been had those positions been liquidated on the filing date.

The fact that the securities were never purchased does not affect this analysis. SIPA necessarily assumes – and as discussed in Section 2 below, the legislative history of SIPA expressly contemplates – that the "securities positions" reflected in the customer's statements may reflect securities that were never actually purchased. That the securities were not actually purchased does not in any way alter the fact that the broker "owes" the customer the value of those "securities positions." Thus, because under SIPA the only permitted offset to the value of the customer's "securities positions" is any indebtedness of the customer to the debtor, absent any margin loans or other such indebtedness, a Madoff customer's "net equity" claim is the value of the "real" securities identified in the customer's confirmations and account statement as of December 11, 2008, the date of the Madoff filing.

By contrast, the Trustee's view on this critical, threshold issue for every claimant in the Madoff SIPA proceeding has no textual support in the statute.[4] To interpret "net equity" as the Trustee does would not only result in claim valuations that are completely inconsistent with SIPA's express language, it would also render the SIPA "net equity" provision entirely superfluous, in contravention of firmly established canons of statutory construction.[5] SIPA expressly includes a clear definition of "net equity" and the Trustee is not free to ignore it. The SEC can and should exercise its authority over SIPC to preclude the Trustee from attempting to engraft upon the SIPA regime a wholesale replacement of its statutory definition with an unprecedented and unsupportable "cash in, cash out" valuation methodology.

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[3] Indeed, each monthly account statement Madoff customers received included a specific section entitled "Security Positions," which set forth (1) the list of securities held in the account at the end of the calendar month, (2) the number of shares of each such security, (3) the price per share of each security position, and (4) the total market value of all the security positions (for both stocks and options).

[4] The Trustee's position also runs counter to what any rational investor would believe she is "owed" by her broker-dealer. Certainly no such investor could conceive that once she has withdrawn over the life of her investment account more money than she had deposited, her broker-dealer no longer "owed" her anything.

[5] *See State St. Bank & Trust Co. v. Salovaara*, 326 F.3d 130, 139 (2d Cir. 2003) ("It is well-settled that courts should avoid statutory interpretations that render provisions superfluous: 'It is our duty to give effect, if possible, to every clause and word of a statute.'") (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001)).

2. The Trustee's View of "Net Equity" Runs Counter to SIPA's Legislative History and Purpose

The Trustee's "cash in, cash out" definition of net equity is also inconsistent with the legislative history of the statute. The paramount concern of the statute, as made clear by its legislative history, is to meet the legitimate expectations of broker-dealer customers. Such legitimate expectations almost always begin and end with what customers see in their written confirmations and monthly account statements, as well as in publicly available information about the securities reflected in those records. In the case of the Madoff Securities customers, these information sources gave them every legitimate expectation that their accounts, in fact, held the securities reflected therein at the prices and values set forth. By disregarding the plain language of the statute, the Trustee has wholly ignored those legitimate expectations, and, in so doing, has acted in direct contravention of the purpose of the statute.

SIPA was enacted in 1970 to protect investors and maintain their confidence in the financial markets. H.R. Rep. No. 91-1613, at 3-4 (1970) ("This legislation [SIPA] . . . is designed to effect two aims. It will establish immediately a substantial reserve fund which will provide protection to customers of broker-dealers . . . . This will reinforce the confidence that investors have in the U.S securities markets. In addition, [it] will provide for a strengthening of the financial responsibilities of broker-dealers.").[6] Under its original statutory scheme, SIPA aimed to do this by satisfying customers' "net equity" securities claims with actual securities, but only if the debtor had securities of the appropriate class and kind available in sufficient quantities to satisfy customers' claims.[7] Otherwise customers would receive the cash equivalents of the filing date value of the securities purportedly held.[8]

In 1978, Congress proposed amendments to SIPA to "satisfy more adequately customer expectations."[9] As Congressman Robert Eckhardt

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[6] *See also In re New Times,* 371 F.3d at 87 ("[T]he [SIPA] drafters' emphasis was on promoting investor confidence in the securities markets and protecting broker-dealer customers."); *Appleton v. First Nat'l Bank of Ohio,* 62 F.3d 791, 794 (6th Cir. 1995) ("'Congress enacted [SIPA] to . . . restore investor confidence in the capital markets[] and upgrade the financial responsibility requirements for registered brokers and dealers.'") (citing *Barbour,* 421 U.S. at 415)); *Sec. Investor Prot. Corp. v. Morgan, Kennedy & Co.,* 533 F.2d 1314, 1318 n.5 (2d Cir. 1976) (same).

[7] SIPA § 6(c)(2)(B)-(D), Pub. L. No. 91-598, 84 Stat. 1636, 1648-50 (1970); H.R. Rep. No. 95-746, at 39 (statement of SIPC Chairman Hugh F. Owens). Under its original enactment, SIPA defined "net equity," in relevant part, as "the sum which would have been owing by the debtor to the customer had the debtor liquidated, by sale or purchase on the filing date, all other securities and contractual commitments of the customer," minus any indebtedness of the customer to the debtor. SIPA § 6(c)(2)(A)(iv), Pub. L. No. 91-598, 84 Stat. at 1648.

[8] SIPA § 6(c)(2)(B)-(D), Pub. L. No. 91-598, 84 Stat. at 1648-50; H.R. Rep. No. 95-746, at 41 (statement of SIPC Chairman Hugh F. Owens).

[9] D 922 Cong. Rec. H. 36326 (daily ed. Nov. 1, 1977) (statement of Representative Robert C. Eckhardt).

commented at the time, "[o]ne of the greatest shortcomings of the procedure under the 1970 Act, to be remedied by [the 1978 amendments], is the failure to meet legitimate customer expectations of receiving what was in their account at the time of their broker's insolvency." *Id.*[10] Those expectations were that the customers owned actual securities, as reflected on their statements, which would be returned to them, whenever possible, "in the form they existed on the filing date." H.R. Rep. No. 95-746, at 21. Thus, SIPA was amended to provide that "[t]he trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities . . . ." 15 U.S.C. § 78fff-2(d); SIPA § 8(d), Pub. L. No. 95-283, 92 Stat. 249, 263 (1978).

Perhaps most importantly to the Madoff proceeding, the SIPA legislative history confirms Congress's intention that broker-dealer customers have valid net equity claims even when the securities reflected on their confirmations and account statements were never purchased. Both the Senate and House reports on the 1978 amendments clearly reflect that a customer's net equity claim is not at all dependent on whether the securities were actually purchased by the broker-dealer:

> "Under present law, because securities belonging to customers may have been lost, improperly hypothecated, misappropriated, *never purchased* or even stolen, it is not always possible to provide to customers that which they expect to receive, that is, securities which they maintained in their brokerage account. . . . By seeking to make customer accounts whole and returning them to customers in the form they existed on the filing date, the amendments . . . would satisfy the customers' legitimate expectations . . . ."

S. Rep. No. 95-763, at 2 (1978) (emphasis added).

> "A customer generally expects to receive what he believes is in his account at the time the stockbroker ceases business. But because securities may have been lost, improperly hypothecated, misappropriated, *never purchased*, or even stolen, this is not always possible. Accordingly, [when this is not possible,

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[10] *See also, e.g., Hearing on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 94th Cong. 63 (1975) ("The basic framework of the 1970 Act in regard to satisfaction of customers' claims should be modified to better meet the legitimate expectations of customers.") (report to the SIPC Board of Directors by the Special Task Force to consider possible amendments to SIPA); *Hearing on H.R. 8331 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 95th Cong. 81 (1977) ("The proposed [1978] amendments carry out the Task Force recommendations and are designed to make the Act more responsive to the reasonable expectations of investors.") (statement of SIPC Chairman Hugh F. Owens); *Hearing on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 94th Cong. 161-62 ("[T]he principal purpose of these amendments is to meet more nearly the reasonable expectations of brokerage firm customers.") (statement of SEC Commissioner Philip A. Loomis, Jr.).

> customers] will receive cash based on the market value as of the filing date."

H.R. Rep. No. 95-746, at 21 (emphasis added).

Neither the 1970 statute, nor the 1978 amendments, nor the legislative history of SIPA provides any support for the Trustee's "cash in, cash out" net equity theory.[11] Rather, it is the straightforward and statutorily based "securities positions" definition of net equity, and not the Trustee's "cash in, cash out" theory, that is in full accord with SIPA's purpose. That "securities positions" definition gives broker-dealer customers the critical comfort that SIPA was intended to provide: knowledge that the securities positions in their accounts – the values of which are publicly verifiable – are protected by SIPC up to $500,000 per account. Importantly, this is so regardless of whether the securities had ever, in fact, been purchased, and regardless of whether, over the life of the account, the customer had taken out more money than she had deposited.

Until this case, an investor did not have to worry – and certainly has never been warned – that SIPA might not mean what it says, that it might not cover what it was intended to cover, and that it might only cover accounts in which the investor's lifetime deposits exceeded her lifetime withdrawals (and then only up to the net of those amounts). Such a drastic departure from a clear statutory provision, that is also so contrary to the underlying purpose of the statute, must not be allowed in any case, including this one.

3. SIPC Precedent and the Leading Second Circuit Authority Are Contrary to The Trustee's Position

SIPC faced very similar circumstances in the New Times Securities Services, Inc. ("New Times") liquidation. There, the New Times Trustee's position on "net equity" was in full accord with SIPA, and thus directly contrary to the Madoff Securities Trustee's position in this case. Specifically, with respect to any claims that were based on confirmations and account statements reflecting securities positions in "real" securities that could have been purchased (i.e., securities that actually existed on the public market and whose valuations were objectively and publicly verifiable by the customers), the New Times Trustee

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[11] As then-SIPC Chairman Hugh F. Owens further explained by way of a hypothetical: "[C]ustomers generally expect to receive what is in their accounts when the member stops doing business. If John Q. Investor has 100 fully-paid shares of IBM and a credit balance of $200 in his account, he expects to receive from the trustee a stock certificate for 100 shares of IBM and a check for $200. But in many instances that has not always been possible because securities have been lost, improperly hypothecated, misappropriated, never purchased, or even stolen." H.R. Rep. No. 95-746, at 39 (explaining that where John Q. Investor only receives the filing date cash value of his IBM securities, he will fail to realize any rise in the IBM stock price since that time). Implicit in Owens' hypothetical is the premise that "John Q. Investor" has a "valid claim" for the number of shares of IBM stock identified in his account statement as of the filing date, even when the brokerage had "never purchased" the stock for him. Nothing in Owens' hypothetical suggests that John Q. Investor's claim should be reduced to the extent he has withdrawn funds from the account over time.

allowed all such net equity claims to the full extent of the filing date valuations of those securities, even though none of the securities identified in those records had ever, in fact, been purchased by the broker-dealer. The Madoff investors are in precisely the same position as the "real" securities claimants in New Times and should be treated no differently.

As with Madoff Securities and Bernard Madoff, New Times Securities and its principal, William Goren, defrauded scores of investors by providing them with confirmations and account statements reflecting purported securities investments made on their behalf when, in fact, no such investments had been made and their money had, instead, been misappropriated for other purposes. Two of the investment opportunities Goren purported to offer were: (1) money-market funds that were entirely fictitious (the "Fictitious New Age Funds"); and (2) mutual funds that were entirely real, such as those offered by The Vanguard Group and Putnam Investments (the "Real Securities"). *See In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 71-72 (2d Cir. 2004) ("*New Times I*"). Goren's was "a classic Ponzi scheme," *Id.* at 72 n.2, wherein new investors' money was used to pay earlier investors.

Approximately 900 customers filed claims in the New Times liquidation: 726 for whom the "Real Securities" were purportedly purchased; 174 for whom the "Fictitious New Age Funds" were purportedly purchased. Consistent with SIPA and its legislative history, the New Times Trustee appropriately applied SIPA's net equity definition to the "Real Securities" customers' claims – meaning he paid them according to the full value of those securities positions as of the date of the liquidation filing. When challenged by "Fictitious New Age Funds" customers who had objected that they had not received the same treatment, SIPC and the New Times Trustee (with the apparent concurrence of the SEC) vigorously defended their approach with respect to the "Real Securities" customers' claims:

- "[O]ur view [is] that when possible, SIPA should be interpreted consistently with a customer's legitimate expectations based on confirmations and account statements." (Br. of the SEC, Amicus Curiae, In Partial Support of the Position of Appellants and In Partial Support of the Position of Appellees ("SEC Amicus Curiae Brief") at 13, *New Times I* (No. 02-6166));

- "In every case [of a 'Real Security' customer], the Trustee has been able to identify the actual mutual fund in question by cross-checking the information supplied by Goren on the customer statements, including share price information, with publicly available information and then been able to purchase that security." (Joint Mem. of Law in Support of Trustee's Motion for an Order Upholding the Trustee's Determinations With Respect to Claims Filed for Investments in Non-Existent Money Market Funds and Expunging Objections to Those Determinations ("Joint Mem. in Support of Order Upholding Determinations") at 26, *SEC v. Goren*, 206 F. Supp. 2d 344 (E.D.N.Y. 2002) (No. 00-CV-970));

- Where customers' statements reflected securities positions in closed mutual funds, "the Trustee properly gave the customers cash equal to the filing date values of the closed mutual funds." (Reply Mem. in Further Support of Trustee's Motion for Order Upholding Determinations at 20, *SEC v. Goren*, 206 F. Supp. 2d 344 (E.D.N.Y. 2002) (No. 00-CV-970));

- "In those cases [that concern the payment of interest/dividends on bona fide mutual funds] the claimants had an objectively legitimate expectation of receiving interest/dividends *because the security in question had actually earned them*. Here, the bogus mutual fund [the Fictitious New Age Fund] was never organized as a mutual fund and had no assets or investments."[12] (Br. for Appellants James W. Giddens as Trustee for the Liquidation of the Businesses of New Times Securities Services, Inc. and New Age Financial Services, Inc. and Securities Investor Protection Corporation ("Br. for New Times Trustee and SIPC") at 38, *New Times I* (No. 02-6166) (emphasis added)).

The New Times Trustee, SIPC and the SEC were not alone in their view that SIPA provides that "real" securities claimants have "net equity" claims based on the value of their "securities positions" as of the filing date, notwithstanding that those securities had never been purchased by the broker-dealer. Two separate panels of the Second Circuit have also considered this issue in the context of the New Times liquidation and similarly endorsed according "real" securities claimants more favorable treatment than "fictitious" securities claimants.

New Times I involved two basic issues: (1) should "fictitious" securities claimants be treated as (a) "cash" claimants who could receive a maximum of up to $100,000 in SIPC advances, or (b) "securities" claimants who could receive up

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[12] SIPC and the New Times Trustee also valued claims by "Real Securities" customers in accordance with SIPA's definition of "net equity," even when those claims included mutual fund shares purportedly purchased through "dividend reinvestments," notwithstanding that no such purchases had, in fact, taken place (precisely because there had not, in fact, been any "dividends" to "reinvest"):

- "[I]nvestors who believed that their accounts held shares of mutual funds that actually existed (but were never purchased for their accounts) are having their claims (both as to shares of mutual funds never purchased by Goren *and shares shown in customer statements as purchased through dividend reinvestment*) satisfied by the Trustee up to the statutory maximum of $500,000." (Claimants' Joint Mem. of Law in Opposition to Joint Motion of Trustee and SIPC for Order Upholding Determinations at 3, *SEC v. Goren*, 206 F. Supp. 2d 344 (E.D.N.Y. 2002) (No. 00-CV-970) (emphasis added)).

- "[W]hereas the Trustee has disallowed that portion of the claim of [the Fictitious New Age Funds] investors representing shares of [the Fictitious New Age Funds] purchased through dividend reinvestment, *the Trustee has allowed that portion of the mutual fund investors' claims [i.e., "Real Securities" investors' claims] as represents shares of such mutual funds purchased by them through dividend reinvestment*." (Limited Objection [of Myrna K. Jacobs] to Trustee's Determination of Claim at 6 n.4, *SEC v. Goren*, 206 F. Supp. 2d 344 (E.D.N.Y. 2002) (No. 00-CV-970) (emphasis added)).

to $500,000 in SIPC advances; and (2) how should "fictitious" securities claimants' (*not* "real" securities claimants') "net equity" be calculated. Before answering these two questions, the court took note of the disparate treatment the Trustee had afforded the "real" and "fictitious" securities claimants, and why he had done so:

> "Meanwhile, investors who were misled by Goren to believe that they were investing in mutual funds that in reality existed were treated much more favorably. Although they were not actually invested in those real funds – because Goren never executed the transactions – the information that these claimants received on their account statements 'mirrored what would have happened had the given transaction been executed.' [Br. for New Times Trustee and SIPC] at 7 n.6. As a result, the Trustee deemed those customers' claims to be 'securities claims' eligible to receive up to $500,000 in SIPC advances. *Id.* The Trustee indicates that this disparate treatment was justified because he could purchase real, existing securities to satisfy such securities claims. *Id.* Furthermore, the Trustee notes that, if they were checking on their mutual funds, the 'securities claimants,' in contrast to the 'cash claimants' bringing this appeal, could have confirmed the existence of those funds and tracked the funds' performance against Goren's account statements. *Id.*"

New Times I, 371 F.3d at 74.

Ultimately, the court concluded, with the benefit of the SEC's views, that (1) a customer's "legitimate expectations," as evidenced by the written confirmations she receives, are paramount, and therefore the "fictitious" securities claimants should have been treated as "securities" claimants who could recover up to $500,000 in SIPC advances, but that (2) "fictitious" securities – which were non-existent and therefore had no publicly verifiable market value and could not be purchased anywhere – would have to be valued simply based on the amount of money those "fictitious" securities customers had initially provided to the debtor.

As to the first conclusion, the Second Circuit agreed with the SEC that it is a customer's legitimate expectations based on written confirmations and account statements that control how a net equity claim is determined. In doing so, the court considered, *inter alia*, SIPC's Series 500 Rules, 17 C.F.R. §§ 300.500-300.503, which were promulgated by SIPC and approved by the SEC, and which confirm the critical importance of written confirmations. The court explained that "the premise underlying the Series 500 Rules [is] that a customer's 'legitimate expectations,' based on written confirmations of transactions, ought to be protected." *New Times I*, 371 F.3d at 87. Although not determinative of the issue facing the court, it nonetheless found the Rules supportive of and consistent with its holding because, "[u]nder the Series 500 Rules, whether a claim is treated as one for securities or cash depends not on what is *actually* in the customer's account but on what the customer has been told by the debtor in written

confirmations." *Id.* at 86 (emphasis in original). *See also In re Oberweis Sec., Inc.*, 135 B.R. 842, 847 n.1 (Bankr. N.D. Ill. 1991) ("The court agrees with the trustee's argument that Congress did not intend to treat customers without confirmations [in a SIPA liquidation] the same as those with confirmations; that customers with confirmations have a legitimate expectation of receiving securities, but customers without confirmations do not have the same expectation.").

With respect to the valuation question, the SEC argued to the Second Circuit that the "net equity" of "fictitious" securities claimants should equal the amount of money invested minus any withdrawals, reasoning that, although "net equity" is equal to the sum that the debtor would have owed the customer had the customer liquidated his or her securities positions on the filing date, "a *fictitious* security cannot be 'liquidated.'" SEC Amicus Curiae Brief at 15 (emphasis added). Accordingly, the values ascribed to such "fictitious" securities on customers' account statements would "necessarily have no relation to reality" because they would be merely "subject to the whim of the broker-dealer who makes up fictitious values for securities and dividends." *Id.* at 16-17. The Second Circuit agreed, finding that basing customer recoveries on "fictitious amounts in the firm's books and records would allow customers to recover arbitrary amounts that necessarily have no relation to reality." *New Times I*, 371 F.3d at 88 (quoting SEC Amicus Curiae Brief at 16).

In short, under *New Times I*, it is only where the "securities positions" reflected on the confirmations and account statements have "no relation to reality" – because they are not objectively and publicly verifiable or capable of replacement – that a "cash in, cash out" valuation methodology is the only reasonable proxy for that customer's legitimate expectations. That is obviously not the situation for Madoff customers.

Two years later, a different Second Circuit panel considered related issues in the New Times liquidation and expressed the very same views regarding the importance under SIPA of meeting a customer's legitimate expectations. *In re New Times Sec. Servs., Inc.*, 463 F.3d 125, 128 (2d Cir. 2006) ("*New Times II*") ("It is a customer's legitimate expectations on the filing date . . . that determines the availability, nature, and extent of customer relief under SIPA."). *New Times II* concerned claim determination objections brought by purchasers of a third type of instrument sold by Goren: fraudulent promissory notes. Those promissory note purchasers were challenging the trustee's position that, as noteholders, they did not qualify as "customers" under SIPA. Of particular relevance to the Madoff case is SIPC's repeated statement that customers' legitimate expectations control even when no securities were ever purchased:

> "[R]easonable and legitimate claimant expectations on the filing date are controlling even where inconsistent with transactional reality. Thus, for example, where a claimant orders a securities purchase and receives a written confirmation statement reflecting that purchase, the claimant generally has a reasonable expectation

> that he or she holds the securities identified in the confirmation and therefore generally is entitled to recover those securities (within the limits imposed by SIPA), *even where the purchase never actually occurred and the debtor instead converted the cash deposited by the claimant to fund that purchase*. . . . [T]his emphasis on reasonable and legitimate claimant expectations frequently yields much greater 'customer' protection than would be the case if transactional reality, not claimant expectations, were controlling, as this Court's earlier opinion in this liquidation well illustrates."

Br. of Appellant SIPC at 23-24 (citing *New Times I*) (emphasis added), *New Times II*, (No. 05-5527).

As the court in *New Times II* explained, it is only in the context of "fictitious" securities claims that the "cash in, cash out" valuation methodology makes sense:

> "*Because there were no such securities*, and it was therefore impossible to reimburse customers with the actual securities or their market value on the filing date (the usual remedies when customers hold specific securities), the [*New Times I* Court] determined that the securities should be valued according to the amount of the initial investment. The court declined to base the recovery on the rosy account statements telling customers how well the *imaginary* securities were doing, because treating the fictitious paper profits as within the ambit of the customers' 'legitimate expectations' would lead to the absurdity of 'duped' investors reaping windfalls as a result of fraudulent promises made on *fake* securities. . . . The court looked to the initial investment as the measure for reimbursement because the initial investment amount was the best proxy for the customers' legitimate expectations."

New Times II, 463 F.3d at 129-30 (citations omitted)(emphasis added).

The "cash in, cash out" valuation methodology employed in *New Times I* with respect to "fictitious" securities claimants has no place in the Madoff case, where customers' confirmations and account statements reflected "real," well-known and publicly verifiable securities. Because the prices and values ascribed to the "securities positions" on those records "mirrored what would have happened had the given transaction been executed," Br. for New Times Trustee and SIPC at 7 n.6, the liquidation filing date value of those "securities positions" is the "best proxy for the customers' legitimate expectations." *New Times II*, 463 F.3d at 130.

The Madoff investors are no different than the "Real Securities" investors in *New Times I*. They received written trade confirmations and monthly account statements that reflected "security positions" for securities that actually existed, and the names and prices of those securities, as reflected on the confirmations and

account statements, were verifiable based on publicly available information. Because they had legitimate expectations that their accounts held bona fide securities, and were earning profits on those bona fide securities, they should be treated just as the "Real Securities" claimants were in *New Times I.*

4. The Trustee's Position Would Materially Erode Investor Confidence

If accepted, the Trustee's interpretation of "net equity" would have significant and far-reaching negative implications well beyond the Madoff proceeding. For the last forty years, individual and institutional securities investors have placed great reliance on a host of statutory and regulatory safeguards. The protections afforded by SIPA and SIPC have been near or at the top of those safeguards since 1970. Acceptance of the Trustee's rejection of SIPA in the Madoff case would not go unnoticed. To the contrary, it would necessarily and materially erode investor confidence in the SIPA regulatory regime, and, as a result, the securities markets and industry as a whole. It would also very likely lead to concerned broker-dealer customers employing a variety of inventive and potentially troublesome techniques to game the system and engage in various self-help efforts to maintain at least some SIPC protection for their accounts. Such actions would be extremely disruptive to the customer and harmful to the securities industry, and would serve no purpose other than to attempt to get around a lawless precedent that would have been set by the Trustee in this case.

For example, if customers are informed that, contrary to SIPA, SIPC may well calculate their "net equity" on a "cash in, cash out" basis, many could decide that they have to take steps on their own to enhance whatever protection they might be entitled to. To the extent they have not been chilled entirely from investing, many could conclude that as soon as their "cash out" level comes within $500,000 of their "cash in" level, they should close their accounts and transfer their holdings to a new broker-dealer.[13] It would only be through that type of convoluted process – wherein the customers are, in effect, hitting the "reset button" – that brokerage customers can believe that they have done what they could to try to salvage at least some of the protection they had thought they were being afforded when SIPA was enacted. We should not need to describe the havoc that such actions would play on the securities industry and markets.

A short example may be helpful to illustrate this concern. Consider a customer with a brokerage account having the following characteristics:

- she opened the account 20 years ago with a $500,000 deposit (and this is the only deposit she ever made into the account);

[13] Smaller-scale customers, whose accounts are worth less than $500,000, may have even more complicated concerns. Those customers will know that every dollar they withdraw – starting with the very first such dollar – will potentially reduce their SIPC protection. As a result, such customers may either decide not to invest at all (because the protection scheme is so complicated and, it turns out, weak), or try to devise some method for spreading their investment activity amongst multiple brokers and/or opening and closing accounts on a regular basis.

- the broker purportedly purchases "real" securities such as IBM, etc.;
- over the life of the account, each year she withdraws anywhere from $25,000 to $50,000 in order to:

  (a) pay taxes on the profits reported on the account, and

  (b) pay living expenses;
- the broker never in fact purchased any securities because he was operating a ponzi scheme; and
- by the time the broker's ponzi scheme is uncovered, the value of the investor's "securities positions" as reflected in the written confirmations and account statements she received – and which were verifiable through publicly available information – had grown to $2,000,000.

According to the Trustee's position, because over the life of the account the customer had withdrawn more than she had deposited, she would have no "net equity" claim and would not be entitled to anything from the SIPC fund. According to SIPA, she would have a "net equity" claim of $2,000,000, thus entitling her to $500,000 from the SIPC fund, as well as her pro rata share of any customer property collected by the trustee. Clearly, if the Trustee's position is upheld, customers such as this hypothetical one would be far better off by closing accounts and switching brokers on a regular basis.

Finally, the Trustee's net equity position would not only provide no compensation to customers who had withdrawn more money than they had deposited, but it would also significantly disadvantage customers who had never taken anything out of their account. Thus, for example, a customer who deposited $100,000, never withdrew anything, and received account statements showing her investment had grown to $400,000 would be made whole under SIPA, but would only receive $100,000 under the Trustee's "net equity" view.

Although the Trustee's approach would undoubtedly result in much of the SIPC reserve fund remaining untapped and unavailable to thousands of Madoff victims, achieving such a result is not the purpose of SIPA and should not be the purpose of the Trustee. To the contrary, SIPA's and the Trustee's purposes are very simply to assist customers in realizing as closely as possible their legitimate expectations.

CONCLUSION

For the reasons set forth above, we urge the SEC to exercise its oversight authority in this matter, not only to ensure that SIPC discharges its obligations as it is required to under the law, but also to ensure that SIPA's purposes are furthered, Madoff customers' legitimate expectations are protected, and all securities investors' confidence in SIPC protection is maintained. Specifically,

we ask that the SEC (1) attempt to persuade the Trustee to follow SIPA, and (2) in the event that effort is unsuccessful, seek a court order requiring him to do so. *See* 15 U.S.C. § 78ggg(b) ("Enforcement of actions. In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under this Act and for such other relief as the court may deem appropriate to carry out the purposes of the Act.").

One final observation: It is not too late to correct the Trustee's error, but soon it will be. The bar date in this case is July 2, 2009. Claims not filed by then likely will never be allowed. The Trustee's numerous public and inaccurate assertions of what the law is with respect to whether Madoff customers have allowable "net equity" claims have undoubtedly influenced and will continue to influence thousands of customers in deciding (1) whether to file any claim at all, and (2) whether to settle their claims (if filed) in accordance with the Trustee's erroneous representation as to what they are entitled to (with the standard accompanying releases to such settlements precluding them from later recovering what they are actually entitled to). Thus, an ultimate court victory by private parties as a result of litigation on this issue will do such customers no good, because that victory will have been too late for them.

We very much appreciate your consideration of this critically important and time sensitive issue which – if resolved in accordance with SIPA – will have a materially positive impact on thousands of Madoff customers, as well as on the broader investing public and securities industry. We respectfully request the opportunity to meet with you and your colleagues at your earliest convenience to discuss this matter with you.

Respectfully,

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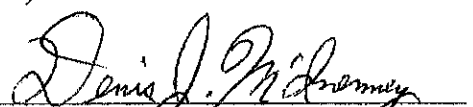

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