No. 10-2378-bk and 10-3188-bk

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE: BERNARD L. MADOFF INVESTMENT SECURITIES LLC.

AMICUS CURIAE BRIEF OF
NETWORK FOR INVESTOR ACTION AND PROTECTION
IN SUPPORT OF APPELLANTS AND SUPPORTING REVERSAL
OF THE JUDGMENT BELOW.

Appeal From an Order of the
United States Bankruptcy Court for the Southern District of New York

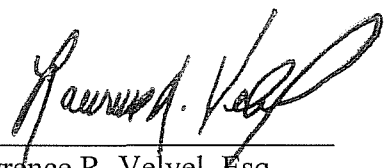
Lawrence R. Velvel
Massachusetts School of Law
500 Federal Street
Andover, MA 01810
Tel: (978) 681-0800
Fax: (978) 681-6330
Email: velvel@mslaw.edu

David Bernfeld, Esq.
Bernfeld, DeMatteo & Bernfeld LLP
600 Third Avenue 15th Floor
New York, NY 10016
Tel: (212) 661-1661
Fax: (212) 557-9610
Email: davidbernfeld@bernfeld-dematteo.com

Attorneys For Amicus

Corporate Disclosure Statement

In accordance with Local Rule 26.1 of the Federal Rules of Appellate Procedure, Amicus Network For Investor Action and Protection ("NIAP") states that it has no parent corporation and has never issued any stock.



Lawrence R. Velvel, Esq.
Massachusetts School of Law
500 Federal Street
Andover, MA 01810
Tel: (978) 681-0800
Fax: (978) 681-6330
Email: Velvel@mslaw.edu

David Bernfeld, Esq.
Bernfeld, DeMatteo & Bernfeld LLP
600 Third Avenue 15th Floor
New York, NY 10016
Tel: (212) 661-1661
Fax: (212) 557-9610
Email: davidbernfeld@bernfeld-dematteo.com

Attorneys For Amicus

Dated: August 12, 2010

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Reports

Books

STATEMENT OF THE IDENTITY OF AMICUS, ITS INTEREST IN THE CASE, AND THE SOURCE OF ITS AUTHORITY TO FILE

Amicus, Network For Investor Action and Protection ("NIAP"), is a nonprofit organization with approximately 850 associate members. It represents investors and their interests, and one of its purposes in this regard is to educate the public about, and to seek protection against, fraud and misconduct that victimize investors. NIAP arose because of the Madoff fraud, has a deep interest in that fraud, and most of its members are victims of that fraud. But NIAP's goals and efforts also extend beyond the Madoff case to other forms of fraud and misconduct that victimize investors, as well as to representation of the general interests of investors.

Since its creation, NIAP has studied the financial, economic, administrative, legislative and legal ramifications of the *Madoff* case and other frauds on investors. It has had the benefit not only of voluminous writings, but also wideranging communications with victims and, because of work it is doing with Congress, of wideranging communications with Senators, Representatives, legislative staffers, and members of the media. In its work it has gained information and perspectives relating to the background and context of this case, both in prior years and more recently. NIAP wishes to bring this background and context to the attention of the Court. With minimal unavoidable exceptions, it does not intend to cover legal questions that are canvassed in the several briefs of appellants, but, as said, only to deal with important background and contextual material. Presenting such material is one classic function of an amicus brief.

NIAP has been authorized by its Board of Directors to file an amicus brief.[1]

---

[1] This amicus brief was written for NIAP by Lawrence R. Velvel and David Bernfeld. Velvel is pro se counsel on his own behalf in this case, and Bernfeld is retained counsel for several appellants. Velvel and

ARGUMENT

I.

The goal of the Securities Investor Protection Act ("SIPA") is to *protect* investors, especially small ones, and to provide them with insurance.[2] Yet the CICO method of determining net equity has *devastated* investors, particularly small ones.

There were thousands of small investors in Madoff. The small investors often are in their 70s, 80s or even 90s and sometimes had their life savings in Madoff -- sometimes as little as a few hundred thousand dollars after a lifetime of working and saving. They depended on taking out money from Madoff -- from what they honestly and legitimately believed were earnings -- to pay for food, clothes and shelter, and to pay income taxes on Madoff earnings. Many are now destitute, sometimes have had to sell their homes to raise money, and have to live with children. Instead of receiving from the Securities Investor Protection Corporation ("SIPC") the protection and insurance Congress intended, they have been the recipients of a nightmare in addition to the fraud, because the use of the cash-in/cash-out method ("CICO") gives them a negative net equity which deprives them of any payment from the SIPC fund. So, contrary to Congress' intent, they get no SIPC payment to alleviate their plight.

They also live in fear. For the Trustee has said he intends to claw back from victims the amounts by which they took out more from Madoff than they put in. In

---

Bernfeld contributed their services to NIAP pro bono. No person contributed money intended to fund the preparation or submission of this amicus brief.

[2] The legislative history, and the Congressional intent which it amply shows, have been thoroughly canvassed in the brief of Lawrence R. Velvel, which discusses the relevant statements from Congressional hearings, reports and debates in 1970, 1975, 1977 and 1978; and have been set out in the Addendum to Velvel's brief (hereafter "VADND"), which contains excerpts from the hearings, debates and reports.

pursuit of that he has sent "lawyers letters" -- which are perceived as harshly worded and threatening -- to small victims of Madoff, including people in their 60s, 70s and 80s. Nor has he said with specificity who, if anyone, may be spared clawbacks. So thousands of people -- all of whom legitimately believed, on the basis of their brokerage statements, that their accounts contained what they were taking out and far more -- are faced with not only having lost all their money, but possibly having to give back money they don't have, i.e., amounts by which their cash-out exceeded their cash-in. (The Trustee and SIPC have made plain that, if (older) people have to sell their homes to pay the Trustee, that is just too bad.) Not protection intended by Congress, but devastation is their portion.

There are also other persons, who are younger and still have, or have found, jobs, but who have nonetheless suffered extensively because of Madoff's collapse, the vast consequent diminution in their resources, a negative net equity that deprives them of payments from the SIPC fund, and threatened clawbacks.

The only persons or institutions who can benefit from cash-in/cash-out are those who did not have to take money out of their Madoff accounts to live and to pay taxes on their Madoff income. Large hedge funds might exemplify. Such persons and institutions have positive net equities under CICO, and will get $500,000 from the SIPC fund. Also, they alone will be eligible to get a share of the customer property recovered by the Trustee, since one needs a positive net equity to be eligible to share in customer property.

Eligibility to share in customer property could be *extremely* consequential. The Trustee has already filed suits seeking the return of somewhere between 13 and 15 billion dollars worth of customer property, and could recover at least many billions of dollars of this money. In fact, the Trustee said in an interview on National Public Radio on July

27th that his "working number" of actual cash invested in Madoff as of December 11, 2008 was "somewhere between 18 and $20 billion," and "I'm hopeful that we can return upwards of 50 cents or even more on the dollar to people."[3] The Trustee thus is hopeful of recovering customer property of nine or ten billion dollars or more (fifty percent or more of 18 to 20 billion dollars).

But because one needs a positive net equity to share in the customer property, the right to share in the Trustee's hoped-for customer property of eight to ten billion dollars or more will accrue only to those who did not have to take out more money from Madoff than they put in in order to live, pay taxes, etc. It thus will not aid small investors who are now living in penury. Yet nowhere did Congress say that the small investor should not benefit from customer property. On the contrary, "the small and frequently unsophisticated investor" was, as the SEC said in 1978, the person at whom "the SIPC Act is most clearly directed."[4]

II.

Although the view is irrelevant because it vitiates Congressional intent, one often hears that people who took out more from Madoff than they put in should receive nothing from SIPC because investment with Madoff was a mark of greed. The truth is different.

Madoff was a pillar of Wall Street -- he was repeatedly head of NASDAQ and a known advisor to the SEC. His fund was regarded as a *conservative* investment, an investment that would return less than many mutual funds or stocks of the time, but in which one's money was safe. (That Madoff's returns were lower than many funds has

---

[3] VADDN, pp. 106-107.

[4] VADDN, p. 77. President Nixon likewise said the Act should help the small investor. VADDN, p. 10.

been calculated elsewhere.)[5] And one need only consider the remarkable returns of investors such as Warren Buffett, hedge fund managers like Julian Robertson or George Soros, or, at the time, Bill Miller of Legg Mason to recognize that greed for outsized returns were not the desideratum of Madoff investors. Safety was.

Investors not only settled for returns that were only medium sized in the years in question, but to gain safety they were willing to pay more than twice the amount in income tax than was paid by investors in mutual funds or stocks. Madoff's supposed profits were ordinary income, taxed at rates of approximately 35 or 36 percent *annually*. The returns from mutual funds and stocks were generally long term capital gains, taxed at 15 percent, and taxed only when gains were "recognized" for tax purposes, so that gains often were amassed without taxes being paid for many years.

III.

In deciding to invest with Madoff, investors relied on the SEC -- which has, but usually does not exercise, supervisory authority over SIPC. The reliance on the SEC included small investors who relied on the agency's remarkable 1992 public statement that it had found no fraud with Madoff,[6] and extended right up to huge investors like James Simons' incredibly successful Renaissance Technologies hedge fund, which relied on the fact that the SEC had vetted Madoff and had access to all the same information

---

[5] See *The Club No One Wanted To Join* (Arvedlund ed., Doukathsan Press, 2010), pp. 214-222.

[6] Randall Smith, *SEC Breaks Up Investment Company That Paid Off Big but Didn't Register (The Wall Street Journal*, Dec. 1, 1992, p. C25); Randall Smith, *Wall Street Mystery Features a Big Board Rival* (*The Wall Street Journal*, Dec. 16, 1992, p. C1).

The SEC Inspector General's Report cited and quoted numerous small investors who relied on the SEC's 1992 statement. *Investigation of the SEC to Uncover Bernard Madoff's Ponzi Scheme,* Rep. No. OIG-509 (Office of the Inspector General of the SEC Aug. 31, 2009) pp. 427-29.

that Renaissance had.[7] In fact, in marketing his fund, Madoff would tell investors he had been vetted by the SEC.

That investors of all sizes relied on the SEC is not surprising since, for nearly seven decades, the SEC enjoyed a reputation as a premier Washington agency. It was only with the revelation of the Madoff and Stanford frauds in 2008 and 2009 that the degradation which had overtaken the SEC was recognized. It is now notorious that the SEC ignored Harry Markopolos for years on end. And, as set forth in the SEC Inspector General's Report, in six purported "investigations" of Madoff from 1992 to 2006 the SEC failed even to call the Depository Trust Corporation to ask what Madoff had in his account, ignored a Barclay's Bank statement that there was little activity in a Madoff account, did not ask the NASD or members of the Chicago Board of Options Exchange whether Madoff was doing the business he claimed, did not look askance at a one-man accounting shop that supposedly audited Madoff, did not look askance when one of Madoff's first feeders, Avellino and Bienes, said -- incredibly -- that it kept no records though it had sent 440 million dollars to Madoff, ignored two letters of warning from an obvious Madoff insider, and ignored the fact that it knew Madoff had lied to SEC personnel to their face. It also failed to speak with major Wall Street figures, suggested by Harry Markopolos, who knew Madoff was not legitimate.[8]

Having failed utterly for 16 years in its duty to protect investors against fraud[9], now the SEC harms them, especially small ones whom it said SIPA was most directly

---

[7] SEC Inspector General's Report, pp. 427-29.

[8] Nor did FINRA (The Financial Industry Regulatory Authority) catch Madoff though FINRA and its predecessor examined him once every two years since the 1960s.

[9] Had the SEC acted at any time prior to approximately very late 2008, it is possible that there would have been many billions of dollars in Madoff's bank account with which to compensate innocent investors. For

designed to protect, by claiming that CICO, not their final statements, is the measure of their net equity. The SEC has supervisory authority over SIPC, but, instead of preventing SIPC from violating the law, it accepts SIPC's cash-in/cash-out theory -- *which has almost never before been used in over 320 SIPC cases.*[10]

IV.

Although it has previously used the final statement method to determine net equity, as Congress intended, in other ways SIPC, the agency established by statute to protect investors against losses, has spent over three decades harming investors by using other legal tactics and strategies to avoid paying them from the SIPC fund. So the use of CICO to avoid paying investors is only the latest such tactic in a long string.

SIPC's efforts to deny payments to investors did not become a cause célèbre until the Madoff case, although it was publicly disclosed many years earlier. In September 2000, Gretchen Morgenson, a well known financial writer for The New York Times, wrote a very lengthy article containing extensive detail about SIPC's efforts to avoid paying investors in case after case.[11] The article contained examples and quotations from lawyers, former state securities commissioners, victims and other knowledgeable persons. The article also pointed out that SIPC had spent 37 percent more on lawyers than on

---

Madoff's account is thought to have been denuded by the withdrawal of billions of dollars by large funds and investors from early to mid 2007 to December 2008, withdrawals made to cover losses in the horrendous financial collapse of those years. SIPC and the Trustee possess, but have not disclosed, the information that would prove or disprove this.

[10] The only exceptions in over 320 cases are the *Old Naples* case (*In re Old Naples Securities, Inc.*, 311 B.R. 607 (2002)) and part of *New Times* (*In re New Times Sec. Servs.*, 371 F.3d 68 (2nd Cir. 2004)). The SEC would modify CICO in some still undisclosed way in the Madoff case to accommodate the time value of money (and concedes that the Trustee and SIPC are wrong in claiming bankruptcy rules regarding clawbacks and preferences apply in a SIPA case), yet would nonetheless use CICO as the beginning point to determine net equity here.

[11] *INVESTOR BEWARE: Many Holes Weaken Safety Net For Victims of Failed Brokerages.* Gretchen Morgenson, *New York Times*, September 25, 2000.

paying victimized investors. But the article sank like a stone. Nobody in authority seemed to care.

Upon occasion courts have commented acerbically on SIPC's conduct, with one federal court saying an argument made before it by the Trustee in order to avoid payment to an investor was so meritless that the court would not have bothered to address it but for the fact that it was pressed so strongly by the Trustee[12] (who is the same Trustee as in the current case and was, *inter* alia, seeking not to use written statements there, as also here). Another court said that Trustees were nothing but a non-independent arm of SIPC, i.e., were a dependency of SIPC. *In re First State Securities Corp.*, 39 B.R. 26, 10 Collier Bankr. Cas.2d 1037 (USDC, SD Fla. 1984).

So SIPC has a long history of evading the duty imposed on it by Congress to pay investors from the SIPC fund, and, as said, its new use of CICO to accomplish this same purpose in Madoff is but the latest example.[13]

In addition, SIPC has avoided steps that would have enabled it to build the SIPC fund to a point where it could handle a major financial disaster like the Madoff case. For many years it charged brokers -- even huge ones with multibillion dollar annual profits like Goldman Sachs -- only 150 dollars per year to be insured by the SIPC fund. For this breathtakingly tiny sum, all brokers, including the Goldman Sachses of the world,

---

[12] The Court said "Except that the Trustee appears to urge this most seriously, the Court would deem the contention too frivolous even to consider." *In re Investors Center, Inc.*, 129 B.R. 339, 351 (1991).

[13] It is widely thought that SIPC's highly unusual use of the CICO method here instead of the final statement method to determine net equity in a SIPC case was motivated in Madoff by fear that the SIPC fund was far too small to make the payments that would have been required if the final statement method was used. And SEC chairman Mary Schapiro told Congress that there was not enough money (VADDN, p. 110.) *But SIPC and the Trustee strenuously resisted discovery on the question of the motivation behind the unusual use of the CICO method in Madoff, and the Bankruptcy Court refused to allow discovery.* (VADDN, pp. 101-102.)

obtained the right to assure investors of protection by SIPC.[14] Also, in 2003 the GAO and several Congressmen warned SIPC that the SIPC fund should be built up because it was too small to handle a major catastrophe. But SIPC declined to build up the fund.

V.

Just as the SEC failed to stop Madoff, so too did a few Wall Street figures fail to report suspicions of Madoff to authorities. Those suspicions were based on professional financial knowledge and expertise not available to ordinary investors, especially small ones. There were some banks, hedge funds, and experts hired by wealthy investors, including foreign ones, who professionally investigated Madoff (often even spoke with him at length), were dissatisfied with his answers, and because of this did not invest with him.[15]

But, except for Harry Markopolos, whom it blew off, and an anonymous figure whom the Inspector General's report called a "hedge fund manager" *(Investigation of the SEC to Uncover Bernard Madoff's Ponzi Scheme,* Rep. No. OIG-509 (Office of the Inspector General of the SEC Aug. 31, 2009, pp. 78, 253)), no Wall Street figures reported and discussed their suspicions with the SEC or other authorities. Had several of them told even the degraded SEC of their (well founded) suspicions, it is entirely possible that Madoff would have been caught years earlier, because it would have been much harder to ignore *several* reports of possible fraud from respected Wall Streeters with

[14] Statements of securities positions received from Madoff carried notice that he was a member of SIPC.

[15] One such person was a Wall Street figure named James Hedges IV, who spent two hours with Madoff, was dissatisfied with his answers, and didn't invest. (Velvel, *Madoff: the first six months*, p. 76 (Doukathsan Press, 2009).)

professional financial knowledge than it was to ignore only the disliked Harry Markopolos and perhaps one other. But silence prevailed on Wall Street.

Many large financial institutions, of course, which had the wherewithal in expertise, manpower and/or money to do due diligence -- which Harry Markopolos has estimated can cost up to $100,000[16] -- did *not* do due diligence. Rather, in order to make the huge commissions and profit being obtained from Madoff, they accepted anything he said. Had they done due diligence, as they should have, and reported Madoff to authorities, once again he would have been stopped.

The ordinary small investor, of course, believed in Madoff because he was the repeated head of NASDAQ, was a known advisor to the SEC, and had a sterling reputation. Not to mention that in 1992 the SEC (which supervises SIPC) publicly announced that it had found no fraud with Madoff -- an announcement of overwhelming importance to many small investors who were already invested with Madoff or thereafter invested with him.[17] Nor did the usual small investor even know of places like the Depository Trust Corporation (and the small investor would not have been told anything by DTC anyway). The small investor did not know that Madoff was doing business with Barclay's but there had been little activity in Madoff's account there, did not know that option traders were not dealing with Madoff and that, as revealed and/or discussed in the Inspector General's Report, there were not enough options in the world to float his alleged option trading, did not know that Madoff's accountant was a one man shop, and so forth. So ordinary small investors, in their innocence, kept investing, while the SEC and on large players on Wall Street did nothing. Now, of course, SIPC, which was the

---

[16] Markopolos, *No One Would Listen*, p. 47 (John Wiley & Sons, 2010).

[17] See note 6 *supra* and accompanying text.

brainchild of Wall Street in 1970, and financially has necessarily been the creature of Wall Street ever since, seeks to harm innocent small investors further, by using CICO instead of the heretofore used final statement method of determining net equity.

VI.

As discussed to some extent in a few of the briefs of appellants, until approximately the time that SIPA was enacted, investors received the physical securities they had bought and thereafter they delivered the physical certificates when they sold them. In the 1960s, because of the amount of securities trading that was occurring, this system of delivery of physical certificates caused a gigantic back office snafu on Wall Street, with accompanying thefts and losses of securities. (VADDN, p. 4.) It was recognized that the only way to overcome the problem was to replace the system of physical acquisition and delivery of securities with a system under which securities were kept in street name, and investors' accounts and statements recorded which securities they owned and how many. When this was done, investors had no way of knowing what securities they owned except as their holdings were shown on statements they received from brokers. Congress simultaneously recognized that an investor's legitimate expectations of what he owned was represented by the securities and cash shown in his account statement from his broker.[18] (Just like bank statements tell a depositor what he has in the bank).

To encourage investors to allow their securities to be kept in street name, and to base their legitimate expectation of what they owned on account statements rather than

[18] VADDN, pp. 61, 67.

demanding physical delivery of securities, was one of the purposes of SIPA.[19] (VADDN, pp. 9A, 57.) SIPA sought to accomplish this purpose by providing investors with insurance payments -- now up to $500,000 -- from the SIPC fund if a broker went down financially.

SIPC and the Trustee, however, are destroying this purpose of SIPA by refusing to honor the amounts shown in an investor's final statement as being the amount he owns. If their position prevails, and if CICO can be used to determine net equity, no investor will ever feel safe, because there is no way for an investor to know, in advance of the collapse of a scheme, whether there has been embezzlement, regardless of whether it be common garden embezzlement or a Ponzi embezzlement. *Every* investor will face the possibility that the securities and money shown in his account statement do not exist due to secret fraudulent conduct, and that, if he withdraws monies from his account in order to live, he may be faced with a negative net equity, no payment from the SIPC fund, no share of customer property, and clawbacks. *It is hard to imagine a situation that more drastically defeats essential purposes of Congress in enacting SIPA.*

VII.

A major goal of SIPA -- constantly set forth in its legislative history, like its other major goals -- is that investors should be paid, or receive their securities, promptly. (VADDN, pp. 17, 19, 43.) This can be accomplished if the final statement method is used to determine net equity, since the final statement received by investors is the measure of net equity. But it is impossible to accomplish this goal if CICO is used. For, *as the Madoff case exemplifies*, when CICO is used, it takes years to determine, for every account, how much cash went into it over decades and how much came out of it over

[19] Investors, of course, plan their lives around what is shown in their accounts.

decades. The complications and permutations are endless because of such matters as lost records, merging of accounts over decades, split-ups of accounts over decades, deaths of some holders of an account but not others, devolution of an account to several heirs, and other complications. In Madoff these problems have already occupied over a year and a half and are certain to occupy several more years, the more so because of trials (perhaps hundreds or even thousands of trials) that will occur on pertinent questions.[20]

Thus -- and even without the exacerbating effect of such trials -- the use of cash-in/cash-out *insures* that Congress' desire that investors receive money or securities *promptly* after the collapse of a broker will be thwarted by SIPC and its Trustee.

VIII.

Making the situation under CICO even more complex and time consuming, moreover, Madoff kept billions upon billions of dollars of investors' money in an account at Chase Bank and then at J.P. Morgan Chase. The money was also invested upon occasion in Treasury bills and other securities. The money earned interest; the amounts of interest on such huge sums over decades must have been enormous. Madoff also kept money at the Bank of New York; it too was used to purchase securities and make profits. By rights, as one of the briefs of appellants discusses, all that interest and profits earned from banks and securities belonged to Madoff's defrauded investors, and should have been added to their "cash-in." This addition could have amounted to very large sums over the years, e.g., four percent interest on, say, one million dollars of initial cash-in over twenty years (many investors were with Madoff for 15 or 20 years or *more*) would be $800,000 in simple interest, without even considering that interest upon interest (i.e.,

[20] The situation is exacerbated by the refusal of the Trustee to provide Madoff investors with records he has purportedly pieced together and from which he derives his claims of what the relevant numbers purportedly are.

compounded interest) would make the figure larger by far. The amount of interest that *should* be credited to an investor could, of course, turn a negative net equity based on cash-in/cash-out into a positive net equity under cash-in/cash-out. But the Trustee and SIPC have ignored that an investor should be credited with interest, and have considered, as cash-in, only the money sent to Madoff by the investor. In their calculations of cash-in/cash-out they have thereby shortchanged investors out of amounts of money that could be enormous, and that could convert negative net equities into positive ones and make an investor eligible for payments from the SIPC fund and a share of customer property even under cash-in/cash-out.

IX.

A major purpose of the 1978 amendments to SIPA was to provide that investors would receive from SIPA the securities that had been in their accounts, rather than cash. Where necessary, SIPC was to go into the market to purchase these securities for the customers of a failed broker dealer, so long as the market was a fair and orderly one rather than one that was being manipulated, for example. (VADDN, pp. 17, 31, 41, 43, 44, 46, 53, 55, 61, 62, 65, 68, 69, 71B, 79, 81, 84.) Congress felt that providing investors with securities rather than cash allowed them to control their own investment destiny, to capture appreciation in the securities, and to avoid potential tax problems.

The securities shown on the account statements of Madoff investors were S&P 100 stocks. They constitute 45 percent of the overall market. They *each* sell in the millions of shares or the tens, scores or hundreds of millions of shares *every day*.[21] The market for them is fair and orderly; it is not being manipulated. They can be purchased in

[21] VADDN, pp. 103-105.

small blocs over time in order to avoid disturbing or moving the market. But at no point, apparently, did SIPC or the Trustee seriously consider obtaining the securities in the market in order to give them to investors -- i.e., in order to give investors the securities shown in their accounts by their statements from Madoff. SIPC and the Trustee thereby frustrated a major feature of the Congressional intent underlying the 1978 amendments to SIPA.[22]

X.

SIPC and the Trustee claim that fairness requires use of the cash-in/cash-out method because, in their personal judgment, it would not be fair for persons who took out more than they put in to Madoff to receive money from the SIPC fund when other investors did not take out money from Madoff or took out less than they put in. But this is the sense of fairness of *SIPC and the Trustee* -- it is *not* what *Congress* decreed. Congress decreed that *all* investors whose account statements showed a positive net equity should receive money from the SIPC fund. Only in that way would the SIPC fund protect the small investor who was the major object of SIPC.

To evade Congress' intent, SIPC and the Trustee claim that giving money from the SIPC fund to investors who innocently took out more than they put in would lessen the amount of money available to others. SIPC and the Trustee ignore that, if the SIPC fund is insufficient to pay up to $500,000 to all investors, then it is SIPC's *duty* to increase the fund by increasing the assessments on brokerage houses and/or by tapping lines of credit. That was Congress' intent.

[22] By failing to promptly give investors the securities showing on their statements, SIPC and the Trustee have caused them to miss out, thus far, on appreciation that has been estimated at approximately 30 percent, depending on the state of the market at any given time.

Beyond this, because it seems that thousands of foreign investors, and many American ones too, now appear not to have filed claims for a variety of reasons (e.g., they did not report Madoff income to taxing authorities, or they keep low profiles in Latin America lest their wealth became known and they became subject to kidnapping), it is not at all clear that the SIPC fund does *not* have enough money in it to pay all claimant investors under the final statement method. Following their normal *modus operandi, SIPC and the Trustee have disclosed no figures that would elucidate the situation in this respect, however.*

SIPC and the Trustee also claim, in support of their supposed inadequacy of funds argument, that the SIPC fund and the recovered customer property fund are but one fund, so that giving money from the SIPC fund to persons who took out more than they put in would diminish the amount available to others from this one integrated fund. But the SIPA fund and the customer property fund are *not* a single fund. *Congress made clear that they are two separate and independent funds.*[23] If the SIPC fund is insufficient to pay investors up to $500,000, SIPC, as said, has the duty to sufficiently increase that fund by increasing assessments on brokers and/or tapping lines of credit, regardless of whether and how much customer property is or is not recovered. So using the final statement method will *not* lessen the amounts available from the SIPC fund for those who took out *less* than they put into Madoff.

Of course, because a positive net equity is necessary to both the right to obtain payment from the SIPC fund and the right to share in customer property, the use of the final statement method will give investors who took out more than they put in a right to share in the separate customer property fund, and in *that* regard -- albeit *not* in regard to

[23] Brief of Lawrence R. Velvel, p. 15, n. 19 and legislative history cited therein.

payments from the SIPC fund -- will lessen the amounts available to pay persons who took out less from Madoff than they put in. But *Congress* decreed that net equity is the measure of both payments from the SIPC fund -- which especially protects the small investor -- and payments from customer property. *It is not for SIPC and the Trustee to thwart Congress' intent* to help the small investor by changing the definition of net equity so that the small investor gets neither a SIPC payment nor a share of customer property.

Moreover, if the Trustee proves right in his belief that he will recover 9 to 10 billion dollars or more in customer property, the recovered customer property may be more than sufficient to pay the entirety of all the claims that have been submitted using the final statement method (especially since so many victims appear *not* to have submitted claims). *The Trustee and SIPC, however, in accordance with their standard modus operandi, again have not disclosed the figures that would reveal whether this is the case.*

Finally we note that SIPC and the Trustee, instead of disclosing the figures that would reveal the *factual* truth about the foregoing points, instead rely on abstract arguments supported by deliberately rigged mathematical illustrations. They claim, in what Justice Harlan used to call an *ipse dixit*,[24] that abstract fairness requires that people who took out less than they put in get money and that people who took out more than they put in shall not receive money. The latter have supposedly been made whole, while the former have not. Their mathematical example, which was adopted by the Bankruptcy Court, has of course been wholly countered by different mathematical examples in the briefs of a couple of the appellants. Moreover, and of enormous consequence, SIPC and

[24] Which translates roughly to "It is because I say it is."

the Trustee pay no heed to the fact that Congress wanted to help the small investor, that small investors acted as innocently as others did, that they *had* to take out money to live and to pay their taxes on Madoff income, that small investors are now in poverty and are desperate, that mathematical examples can be constructed on every side of an argument, and that small investors too, *rather than having been made whole,as SIPC and the Trustee wrongly contend, have, like all investors, suffered lost opportunity cost -- lost chances to invest elsewhere for a profit, as well as often having been cast into present penury.*[25] [26]

XI.

In their briefs in the court below, SIPC and the Trustee spent many pages saying that everything in Madoff was faked -- the alleged purchases of securities, the alleged sales of securities, and the alleged earnings of investors.[27] The object of this exercise in lengthily describing the fakery was to persuade that normal rules should not apply regarding net equity because there were no real purchases and sales (as also occurred in *New Times* when investors thought they were purchasing securities which existed in the real world and the final statement method was used with respect to those investors). Instead of any real purchases and sales, it is said, Madoff simply stole money, simply

---

[25] For another mathematical example contrary to the one constructed by SIPC and the Trustee (whose construct was quoted by the court below), see Velvel, *Madoff and Not Madoff*, p. 242 (Doukathsan Press, 2010).

[26] As part of their erroneous "fairness" argument, SIPC and the Trustee say that innocent people who took out more than they put in were paid with other people's money. But they ignore that the money invested by those who took out more than they put in was itself used to pay still other people. They also ignore that innocent investors who closed out their accounts more than six years before December 11, 2008 were paid with other people's money, but there is no way to obtain returns of such payments.

[27] We note, as said above, that interest was earned on money in Madoff's accounts and that there were *some* investments in securities made with monies from those accounts. The Trustee and SIPC ignore this in their arguments, have not disclosed the amounts of interest paid on, or the amount of profits made with, the money in Madoff's accounts, and have not credited investors with any part of such money.

embezzled it (as again occurred in *New Times).* A Ponzi scheme, after all, is nothing but one particular form of theft and embezzlement of money.

But, as various of the Appellants' briefs have said, Congress made clear its intent that SIPA applies full force when there is theft or embezzlement. Not only was theft one of the problems SIPA was intended to protect against when the Act was passed in 1970,[28] but the legislative history of the 1978 amendments *repeatedly* said the Act protected investors where securities were "never purchased." This was said in 1975 hearings, in the 1977 House Report, in a statement by Chairman Owens of SIPC quoted in the 1977 House Report, and in the 1978 Senate Report.[29] These same documents likewise said explicitly that SIPA was to protect investors where their securities are "stolen" or "misappropriated," and therefore were missing.

In this case the securities apparently were "never purchased." Investors' funds, which the investors intended to be used for the purchase of securities, were instead "stolen" and "misappropriated." So this case, like any Ponzi scheme, fits Congress' intent to protect investors when shares were "never purchased" (and thus were missing), and investments were embezzled, or stolen, or misappropriated.

Desiring to avoid Congress' explicit intent to protect investors where securities were never purchased, SIPC and the Trustee claim CICO should be used because, in the *New Times* case,[30] it was used where mutual funds had *not* existed in the real world although the final statement method had been used where funds *did* exist in the real world

---

[28] This appears in the legislative history appearing in VADDN, p. 4, and is cited in Velvel's brief at p. 22.

[29] VADDN., pp.39-40, 61, 67, 79

[30] *In re New Times Sec. Servs.*, 371 F.3d 68 (2nd Cir. 2004).

but had not been purchased. The Trustee in *New Times* felt that, where mutual funds had actually existed but had not been bought, it was possible to go into the market to obtain them, and to determine what investors would have had if the funds *had* been bought by looking at the prices of the funds in the real world. But the Trustee felt in *New Times*, and SIPC and the SEC told the Court there, that looking at real world prices was not possible where the mutual funds had never existed, and therefore the fraudster would be determining profits and the SIPC fund would be unacceptably exposed, if final statements were used.

What SIPC and the SEC told the Court regarding prices where mutual funds never existed in the real world is irrelevant here because here the securities did exist in the real world and the prices reported by Madoff could be checked against real world prices. But claims that the fraudster would determine profits and the SIPC fund would be unacceptably exposed is not even true where securities do *not* exist in the real world . For in the real world, as opposed to the theory of SIPC and the Trustee, what the prices and financial results *would* have been had the situation been different are *regularly* determined by financial experts and in litigation. (Lawyers sometimes call this the "but for" analysis.) Indexes such as the S&P 100 or the S&P 500, results achieved by competitors, and statistical methods are used to determine what the financial and monetary results *would* have been. *This is common.* There was indeed a Madoff competitor, the Gateway Option Income Fund, which used the same investment technique that Madoff purported to use, and whose results can be a surrogate for Madoff when doing financial analysis. And when investigating Madoff, Henry Markopolos used financial and statistical techniques to determine what Madoff's results *should* have been

using the "split-strike conversion" strategy. So there are and long have been ways to determine what financial results *would* have been, and there is therefore no way, even where securities did *not* exist in the real world, that a fraudster like Madoff would be able to get away with assigning whatever value he chose to accounts no matter how high the assigned value. Nor, consequently is there any way that the SIPC fund would be unacceptably exposed. *In any event, here the securities did exist in the real world and the prices of purchases and sales reported by Madoff could be checked against real world prices, so the normal final statement method of determining net equity is applicable.*

The argument based on part of *New Times* which is being made by SIPC and the Trustee is merely a way of trying to escape Congress' *repeatedly* expressed intent that SIPA protects investors even when securities, as in Ponzi schemes, were never purchased, or were stolen or misappropriated -- to protect investors when there were no purchases or there was embezzlement or theft.

CONCLUSION

The background and context of this case, both over the decades and recently, supports the Appellants' claim that the decision below should be reversed.[31]

Respectfully submitted,

---

[31] In a July 30, 2010 press release, the House Financial Services Subcommittee on Capital Markets, extensively quoting Subcommittee Chair Kanjorski and Vice Chair Ackerman, announced a September 23, 2010 hearing on SIPC and SIPA. The Subcommittee's announcement -- making several points made here as well -- criticized SIPC for not using the final statement method of determining net equity and said SIPC should instead "follow[] the spirit of the existing law;" said SIPC has a responsibility to provide insurance to investors but its response "to the Madoff fraud and other Ponzi schemes has been totally inadequate;" said that thousands "remain destitute from financial frauds because *SIPC is determined to pay out as few claims as possible*" (emphasis added); criticized the fact that SIPC has provided insurance to *broker-dealers* "for less than most Americans pay for an auto insurance policy" (emphasis added); said victims of fraud should be "better protected by the assurances SIPC *was intended* to provide" (emphasis added); and said confidence in markets will increase when SIPC is "committed to placing *investors'* interests first" (emphasis added). (VADDN, pp. 108-109.)

Lawrence R. Velvel, Esq.
Massachusetts School of Law
500 Federal Street
Andover, MA 01810
Tel: (978) 681-0800
Fax: (978) 681-6330
Email: Velvel@mslaw.edu

David Bernfeld, Esq.
Bernfeld, DeMatteo & Bernfeld LLP
600 Third Avenue 15th Floor
New York, NY 10016
Tel: (212) 661-1661
Fax: (212) 557-9610
Email: davidbernfeld@bernfeld-dematteo.com

Attorneys For Amicus

Dated: August 13, 2010

R:\My Files\Madoff\AmicusBrief.NIAP.doc

Federal Rules of Appellate Procedure Form 6. Certificate of Compliance With Rule 32(a)

Certificate of Compliance With Type-Volume Limitation,
Typeface Requirements and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

☑ this brief contains 5,801 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), ***or***

☐ this brief uses a monospaced typeface and contains lines of text, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because:

☑ this brief has been prepared in a proportionally spaced typeface using MS Word 2003 in Times New Roman 12 pitch

or

☐ this brief has been prepared in a monospaced typeface using with .

(s) /s/Lawrence R. Velvel

Attorney for Network For Investor Action and Protection

Dated: August 13, 2010