

Response to: Another View: Unwinding Madoff's Fraud, Fairly May 6, 2009, 11:46 am

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Based on the May 6, 2009 article by Messrs. Picard and Harbeck, it appears that the Securities Investor Protection Corporation ("SIPC") has totally disregarded the Securities Investor Protection Act ("SIPA").

Picard and Harbeck state that they want to be "fair and equitable" in the treatment of Madoff investors. However, Congress did not intend for SIPC and its trustees to decide what is "fair and equitable" and nowhere in SIPA does it state that a trustee for an insolvent broker/dealer should exercise his own judgment as to what is "fair and equitable" in paying customers SIPC insurance. Unfortunately, what SIPC finds "fair and equitable" is to protect Wall Street and short-change investors.

In the past, SIPC has charged brokers and dealers only \$150 per year for SIPC insurance of \$500,000 per customer. Thus, Goldman Sachs paid a total of \$150 per year to print on every single trade confirmation the fact that the customer's account was protected by \$500,000 in SIPC insurance. This was the greatest bargain of the 20th Century. Wall Street has reaped the benefits of having SIPC insurance because it inspired trillions of dollars of investment by innocent, hardworking Americans. Now that it is time for SIPC to make good on its promised insurance, SIPC has decided to be "fair and equitable" instead of complying with SIPA because it does not have sufficient funds to satisfy its statutory obligations and it obviously does not want to burden Wall Street with the fair cost of the insurance.

SIPA was enacted in 1970 in order to protect the "legitimate expectations" of customers of SEC-regulated broker/dealers and to encourage investment in American securities. Under SIPA, a trustee for an insolvent SEC-regulated broker/dealer is required to "promptly satisfy all obligations of the member to each of its customers" based upon the customer's "net equity" up to \$500,000. 15 U.S.C. Section 78fff-4(c). In five months, SIPC has paid 51 claims. A rate of ten per month is hardly "prompt" payment, as required by SIPA. Many Madoff victims are elderly people who lived on their Madoff income. Because these people have had no income since December 11, 2008, they have been forced to go on welfare, use food stamps, and sell their homes for a fraction of what they are worth. For these people, SIPC's failure to "promptly" pay customer claims has been absolutely devastating. Picard's excuse for not paying claims promptly is that he needs forensic accountants to go through decades of records to determine the amount of each customer's claim – even where the customer is a "hardship" case. Congress did not intend for a SIPC trustee to employ forensic accountants to do years of investigation before customer claims were paid. On the contrary, under SIPA, a customer's claim is the customer's "net equity" which is the amount the broker owes the customer less any

sums the customer owes the broker. 15 U.S.C. Section 78lll(1). A customer's net equity under SIPA is easily determined by looking at the customer's last brokerage statement.

As if anticipating SIPC's present attempts to escape its obligations, Congress provided in SIPA that SIPC is prohibited from changing the definition of "net equity." 15 U.S.C. Section 78ccc(b)(4)(A). And, under SIPC's Rule 502, as long as the customer received written confirmations of transactions from the broker/dealer (as all Madoff customers did), the customer is entitled to the securities shown on his last statement (or up to \$500,000 in cash), even if the dishonest broker pocketed the money and, like Madoff, never bought the securities.

Ignoring these SIPA provisions, SIPC/Picard have created a new definition of "net equity," one never before used by SIPC. Under this new definition, SIPC/Picard will only allow claims in the amount of the customer's net investment, disregarding all appreciation in the account that was indicated to have occurred over a period of, in some cases, 40 years. Thus, according to Picard, an investor who invested \$10,000 in 1960, which grew to \$2,000,000 in 2008, is only entitled to SIPC insurance of \$10,000 even though, if the money had been in US Treasury Notes for that same period of time, the money might have grown to \$1,600,000.

SIPC/Picard's justification for taking the law into their own hands and creating a new definition of "net equity" is that Madoff was operating a Ponzi scheme and Madoff admitted that, at least since the early 1990's, he never bought securities for his customers. However, for decades, SIPC has paid claims based upon the customer's actual balance on his last statement in numerous Ponzi scheme cases, including a case that went to the Second Circuit. 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.").

On May 7, 2009, I met with Thomas McGowan of the SEC and pleaded with him to have the SEC enforce the statute, as it is empowered to do under SIPA. 15 U.S.C. Section 78ggg(b); *Securities Investor Protection Corporation v. Barbour*, 421 U.S. 412, 417 (1975) (SEC has plenary authority over SIPC.). I explained the urgency of the situation because of the devastation caused by the delay to thousands of investors and because Picard, as the court-appointed trustee, is mis-representing the law to financially desperate investors whom he is inducing to waive their right to \$500,000 in SIPC insurance in exchange for an immediate payment of some lesser sum. I told Mr. McGowan that I found this conduct unconscionable. I explained to Mr. McGowan that Picard's definition of "net equity" is particularly devastating to elderly people who have been long-term Madoff customers and who, conveniently for SIPC, have no "net equity" on Picard's definition and are not entitled to any SIPC insurance. Many of these investors have not filed SIPC claims, which must be

filed by July 2, 2009, because they mistakenly believe that they are not entitled to any insurance, based upon what Picard has told them.

In addition, Picard has announced his intention to “claw back” distributions that were made to Madoff investors in excess of their “net equity” under his calculation. Thus, an 85-year-old widow who has been withdrawing 10% of her investment each year to support herself and pay taxes will be required by Picard to pay back whatever distributions she received in the past six years. These elderly investors have not only been divested of their net worth other than their houses; they are now being threatened with losing the proceeds of their houses, which they were forced to sell at a fraction of their values, so that they would have money to pay their basic living expenses.

And we are being told that this is “fair and equitable.” I am a 2005 Madoff investor who never took a dime out of my account as a distribution. Hence, I would benefit from Mr. Picard’s clawback campaign for two reasons: First, my “net equity” according to Picard is a higher percentage of the November 30, 2008 balance in my account. Second, I am not subject to a “clawback” and would receive a greater distribution from the bankruptcy estate if Picard “clawed back” money from investors who received distributions.

Nevertheless, I am vehemently opposed to “clawbacks” because I feel they are morally outrageous and legally unsustainable. Clearly, if an investor was complicitous in Madoff’s Ponzi scheme, that investor should be sued to recover the illegal profits realized. However, the vast majority of potential “clawback” defendants are totally innocent investors who relied upon the SEC’s stamp of approval of Madoff and never had any reason to suspect that Madoff was operating a Ponzi scheme. To “claw back” money from these people is insupportable.

There is no case decided under SIPA, to my knowledge, where a SIPC trustee was allowed to claw back distributions to investors. On the contrary, numerous courts have recognized that the purpose of SIPA is to honor the “legitimate expectations” of securities customers so as to promote confidence in the American securities markets. (See 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 confirmations sent by the broker to the customer.) Nothing could be more destructive to the legislative intent of SIPA than the present conduct of SIPC and Picard.

I asked Mr. McGowan what authority SIPC/Picard were relying on for their present conduct. Mr. McGowan told me they were relying on a 1924 decision of the United States Supreme Court involving a preference recovery in the original Ponzi case. I pointed out to McGowan that the case was decided 46 years before SIPA was enacted and ten years before the SEC was even created! Hence, the case could not conceivably justify Picard’s new definition of “net equity” under SIPA.

I call upon the SEC to immediately demand that SIPC and Picard abide by the law and “promptly” pay all Madoff investors the full \$500,000 of SIPC insurance to which they are entitled, based upon their last statement from Madoff. If the SEC fails to fulfill President Obama’s promise of a new era

of government responsibility, then the Madoff victims will be victims yet again of the SEC's incompetence and there will be serious reason to question the purpose of the SEC's continued existence.

Ms. Chaitman is a partner of Phillips Nizer, LLP in New York City. She has been working pro bono with approximately 350 Madoff investors.

— *Helen Davis Chaitman*