

## A DEFENSE FOR MADOFF INVESTORS?

Anyone following the Madoff disaster knows that Irving Picard, the bankruptcy trustee has had his hands full filing over a thousand complaints against investors who profited from the jailed financier's Ponzi scheme. Those lawsuits, called "clawback" actions, allege for the most part that investors who withdrew monies from their accounts fraudulently transferred bankruptcy estate property, regardless of whether they actually lost more than they gained.

These types of "clawback" suits have been historically difficult to fight. The case generally revolves around the concept of "inquiry notice." A Federal Bankruptcy Court in New York recently held that an investor is considered to be on "inquiry notice" once the investor becomes aware of facts that objectively should have led them to believe that there was "some infirmity in the fund" or "some infirmity in the integrity of management." Moreover, that same Court held that investors would not be able to take the position that since others failed to detect the fraud, any investigation on the investor's part would have been futile. Once on "inquiry notice" an investor is essentially precluded from arguing the good faith defense. The good faith defense asserts that the investor had no knowledge whatsoever that they were invested in a Ponzi scheme.

On appeal, the Federal District Court reversed the bankruptcy court and redefined the circumstances under which an investor would be under "inquiry notice." Christian Bros. High School Endowment v. Bayou No Leverage Fund, LLC, 439 B.R. 284 (S.D.N.Y. 2010). The District Court held that investors are on "inquiry notice" *only* if they are aware of facts that would indicate that their investment vehicle is fraudulent or insolvent. Most importantly, given the facts of the Madoff case, the Court further noted that investors may cite the actions or inactions of others to establish that any investigation would have been futile. Madoff investors will no doubt use this appellate decision to argue that since the SEC looked at Madoff and found no fraud, how can the investor be expected to find more? That will be the billion dollar question.

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