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Litigation and Securities Advisory: Litigation Triggered by Madoff Collapse

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This is our second update regarding the collapse of securities firm Bernard L. Madoff Investment Securities LLC ("BMIS") and the associated fraud scheme to which its founder, Bernard Madoff, admitted in December.

The alleged "Ponzi" scheme has affected countless investors. The many news items and the numerous court cases that have been filed to date (summarized below) suggest that investors are hoping against the odds to find assets and to reduce their losses.

As we previously reported, the Securities Investor Protection Corporation ("SIPC") provides limited coverage—up to a maximum of $500,000, inclusive of $100,000 for cash. SIPC coverage information is available here.

On January 2, 2009, the trustee charged with liquidating BMIS issued a notice outlining the requirements for filing SIPC claims. Anyone having a claim or potential claim against BMIS should read that notice. It provides that customers of BMIS must file their claims with the trustee on or prior to **March 3, 2009** to receive the maximum protection. It further provides that a first meeting of BMIS's customers and creditors will be held on February 20, 2009, at 10:00 a.m., at the Auditorium at the United States Bankruptcy Court, Southern District of New York, One Bowling Green, New York, New York 10004. The trustee also has established an official web site to provide public information about the bankruptcy court proceeding.

To date, a number of lawsuits have been filed against BMIS and others in connection with the collapse of BMIS. Since the unveiling of the alleged "Ponzi" scheme, individual and class action lawsuits have been filed in both federal and state court, by plaintiffs ranging from individuals to large well-known entities such as New York University. At least ten federal class action suits and one state class action suit in New York have been filed. (We envision many objections to the certification of the purported classes, and we offer no opinion whether the purported classes are likely to be certified.) Individual suits also have been filed in federal and state courts in New York, with additional suits no doubt to follow. The claims in the filed actions generally include allegations of securities fraud, negligence, misrepresentation, breach of fiduciary duty, unjust enrichment, and deceptive acts and practices.

Suits Filed against Madoff

Perhaps the most typical lawsuits that one might expect to see in a situation such as this one are those filed by investors against Madoff and his entities. The most notable of such actions filed to date include class actions *Kellner v. Madoff*[1] and *Chaleff v. Madoff*[2] and individual action *Sciremammano v. Madoff*.[3]

The *Kellner* case asserts a class action on behalf of all persons and entities who invested with Madoff, BMIS, or other selling agents affiliated with Madoff or BMIS, from as early as the formation of BMIS in the 1960s. The complaint alleges violations of the securities laws and related federal laws, including the Racketeer Influenced and Corrupt Organizations Act (commonly known as "RICO") and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, violations of New York General Business Law provisions concerning deceptive acts and practices, fraud, negligent misrepresentation, breach of fiduciary duty, conversion, and unjust enrichment.

In the *Chaleff case,* a class action was brought against Madoff, BMIS, Brighton Company and its general manager, Stanley Chais, alleging securities law violations on behalf of all persons or entities that invested through or in Chais or Brighton, had capital invested with Madoff or BMIS on December 12, 2008, and who were damaged thereby.

The plaintiffs in the *Sciremammano* case are individuals who began investing with Madoff in 1995. They seek injunctive relief to stop the alleged fraud and preserve assets, disgorgement of gains with interest, and civil monetary penalties. The alleged violations include fraud under the federal securities laws, fraudulent practices under New York state law, violations of the Investment Advisers Act of 1940, and breach of fiduciary duty.

Suits Filed against Others

Numerous Plaintiffs also have sought recourse for their damages by suing firms that led them (knowingly or otherwise) to invest with Madoff, as well as accountants and individuals associated with those firms. At issue in many of these cases will be whether the defendants conducted proper due diligence and research when determining whether to invest, or advise others to invest, in BMIS. Many of the complaints allege that Madoff was secretive regarding his investment strategy, and that his secrecy itself should have been a "red flag" to those who invested plaintiff funds with Madoff or advised plaintiffs to invest with BMIS. Some examples of these actions against third parties include the following:

New York Law School v. Ascot Partners, L.P.[4] is a purported class action brought on behalf of those who invested in Ascot Partners, L.P. between December 16, 2002 through December 16, 2008 to recover damages from the fund, its founder, manager, and general partner J. Ezra Merkin, and BDO Seidman, LLP, the fund's independent auditor. The complaint alleges that the Madoff fraud was facilitated by the defendants who recklessly, with gross negligence and in breach of fiduciary duties caused the $1.8 billion investment capital of Ascot to be decimated. The alleged negligence includes the auditor's failure to spot "red flags" of the high risk to Ascot of investing with Madoff and that the auditor failed to comply with generally accepted accounting standards. The plaintiffs also claimed violations of federal securities laws as well as common law fraud and negligence.

Other similar suits have been filed against Ascot, Merkin, and Seidman, including: class action *Berrie v. Gabriel Capital, L.P.*,[5] brought on behalf of all investors in Gabriel Capital (a fund managed by Merkin) between December 16, 2002 and December 16, 2008; individual action *The Calibre Fund, LLC v. J. Ezra Merkin*,[6] filed by a fund that invested over $10 million with Ascot; and individual action *New York University v. Ariel Fund Limited*,[7] to recover damages for investments lost through endowment fund Ariel Fund Limited (an offshore "fund of funds") from the fund, principals Merkin and Fortis Bank, investment adviser Gabriel Capital, and certain BDO entities that served as the fund's auditors.

Arthur E. Lange v. Massachusetts Life Insurance Company[8] is a purported class action brought on behalf of all investors in the Rye funds (funds of funds Rye Select Broad Market Fund, L.P. and Rye Select Broad Market Prime Fund, L.P.) who had not redeemed their interests as of December 11, 2008, alleging failure by the defendants (including the Rye funds, its investment adviser Rye Investment Management Group, VP of investor services at Rye, and related entities Tremont Group Holdings, Inc., Oppenheimer Acquisition Corporation, and Massachusetts Mutual Life Insurance Company) to investigate and monitor Madoff's and BMIS's activities in the face of numerous indicators of fraud. The complaint alleges that defendants ignored "red flags" including Madoff's "suspect strategy," that trading volumes reflected in accounts were vastly in excess of actually reported trading volumes, the operation of Madoff through managed accounts rather than through a hedge fund of his own, and the lack of a third-party custodian and administrator.

Additional cases have been filed against the Tremont entities, including purported class actions *Yvette Finkelstein v. Tremont Group Holdings Inc.*,[9] brought on behalf of all persons who were clients of Tremont from January 1, 2003 onward (and a derivative action brought by a limited partner of American Masters Broad Market Prime Fund, L.P. on behalf of the fund) against Tremont, Oppenheimer, Massachusetts Mutual Life Insurance Company, and Ernst & Young LLP to recover damages for fraud and breach of fiduciary duty, including failure to conduct proper due diligence; *Arthur M. Brainson IRA R/O v. Rye Select Broad Market Fund, L.P.*,[10] brought on behalf of investors in the Rye Select Broad Market Fund, L.P. (a fund managed by Tremont-affiliated entities) against the fund and related parties, alleging the failure by defendants to conduct reasonable due diligence and that defendants ignored "red flags" that Madoff's activities were illegitimate including lack of transparency into BMIS and minimal volatility in BMIS returns; and *Group Defined Pension Plan & Trust v. Tremont Market Neutral Fund, L.P.*,[11] brought on behalf of investors in Tremont Market Neutral Fund, L.P. (formerly American Masters Market Neutral Fund, L.P.) from 2002 onwards against the investment partnership, related entities, and its auditors, Ernst & Young LLP, alleging that approximately 27% of the investment capital of Tremont was invested with Madoff.

Repex Ventures v. Madoff[12] is a purported class action brought on behalf of purchasers of investments in funds that were controlled or managed by Bank Medici and then provided to Madoff between January 12, 2004 and January 12, 2009 against Madoff, BMIS, Medici, certain feeder funds for Madoff and BMIS, related entities, and accountant for the funds, Ernst & Young LLP.

Pasha S. Anwar v. Fairfield Greenwich Group[13] is a purported class action brought on behalf of all persons who owned equity interests in Greenwich Sentry, L.P. or Fairfield Sentry Fund on December 10, 2008 for breach of fiduciary duty, negligence, and unjust enrichment arising out of the defendants' mismanagement of investments. See also *Inter-American Trust v. Fairfield Greenwich Group,*[14] filed on behalf of shareholders in the Fairfield Sentry fund on December 11, 2008; and *Pacific West Health Medical Center Inc. Employees Retirement Trust v. Fairfield Greenwich Group,*[15] filed on behalf of owners of shares of Fairfield Sentry as of December 10, 2008.

The outcomes of those cases, and the courts' decisions on whether to certify the purported classes, wait to be seen. Updates as to the likelihood of recovery from various possible defendants should be interesting as these cases develop. If you would like to discuss your options going forward, and particularly if you believe you fall into any of the classes for which actions have been brought, please contact us.

Endnotes

[1] No. 08CV05026 (E.D.N.Y. filed Dec. 12, 2008).

[2] No. 08CV08260 (C.D. Cal. filed Dec. 15, 2008).

[3] No. 08CV11332 (S.D.N.Y. filed Dec. 30, 2008).

[4] No. 08CV10922 (S.D.N.Y. filed Dec. 16, 2008).

[5] No. 08CV10930 (S.D.N.Y. filed Dec. 16, 2008).

[6] No. 08CV11002 (S.D.N.Y. filed Dec. 18, 2008).

[7] No. 08CV603803 (N.Y. Sup. Ct. filed Dec. 23, 2008).

[8] No. 08CV11117 (S.D.N.Y. filed Dec. 22, 2008).

[9] No. 08CV11141 (S.D.N.Y. filed Dec. 22, 2008).

[10] No. 08CV11212 (S.D.N.Y. filed Dec. 23, 2008).

[11] No. 08CV11359 (S.D.N.Y. filed Dec. 30, 2008).

[12] No. 09CV00289 (S.D.N.Y. filed Jan. 12, 2009).

[13] No. 08CV603769 (N.Y. Sup. Ct. filed Dec. 19, 2008).

[14] No. 09CV00301 (S.D.N.Y. filed Jan. 12, 2009).

[15] No. 09CV00134 (S.D.N.Y. filed Jan. 8, 2009).

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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