MINTZ LEVIN
Mintz Levin Cohn Ferris Glovsky and Popeo PC

Litigation and Securities Alert: Collapse of Bernard L. Madoff Investment Securities LLC

12/18/2008

This is an 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 last week.

Last Friday, December 12, 2008, the U.S. District Court for the Southern District of New York ("SDNY"), in a proceeding commenced by the U.S. Securities and Exchange Commission (SEC), appointed Lee S. Richards of the law firm of Richards Kibbe & Orbe LLP as receiver for BMIS.

On Monday, December 15, 2008, the Securities Investor Protection Corporation (SIPC), the securities-industry-funded nonprofit membership organization for broker-dealers which maintains a special reserve fund authorized by Congress to restore funds to investors at failed brokerage firms, announced that it is liquidating BMIS (a SIPC member) under the Securities Investor Protection Act of 1970 ("SIPA") and commenced a liquidation proceeding in the SDNY. The court determined that BMIS's customers are in need of the protection afforded by SIPA and appointed Irving H. Picard as trustee for the liquidation of BMIS and the law firm of Baker & Hostetler LLP as counsel to Mr. Picard. The assets of BMIS are frozen at this time. The liquidation proceeding was transferred to the Bankruptcy Court and is now before Bankruptcy Judge James M. Peck.

What Does SIPC Protect?

The SIPC fund is designed to protect customer claims for cash and securities lost due to a brokerage firm's insolvency. Most customers of a broker-dealer with cash and securities missing from their accounts are eligible for SIPC protection. SIPC protects investments in most types of securities, such as notes, stocks, bonds, mutual funds, and other registered securities and cash, but does not cover commodity futures contracts, currency, or unregistered investment contracts, limited partnership interests, or fixed annuity contracts. Under SIPC, customers of failed SIPC broker-dealer firms should receive all securities that were (at the time of the broker-dealer's failure) registered in the customer's name or were in the process of being registered. The brokerage firm's remaining assets then should be distributed to customers on a *pro rata* basis after paying the costs of administration. If sufficient funds are not available in the firm's customer accounts to satisfy customer claims, the SIPC reserve funds are available, providing protection to cover losses related to theft and unauthorized trading for each customer account of up to $500,000 for claims for cash and securities, with a maximum of $100,000 for cash claims. Multiple accounts held in the same customer name will be treated as one account for SIPC coverage, whereas if a customer has one account in an individual name and another in the name of a trust, such accounts will be treated as two separate accounts for SIPC coverage.

SIPC does not protect against losses caused by a decline in the market value of the securities during the liquidation process. Additionally, SIPC funds do not cover claims by any customer who also is:

- a general partner, officer or director of the brokerage firm;
- the beneficial owner of greater than 5% of any class of security of the brokerage firm (with certain exceptions);
- a limited partner with a participation of 5% or more in the net assets or net profits of the brokerage firm;
- an individual with controlling influence over the management or policies of the brokerage firm; or
- a broker or dealer or bank acting for itself rather than its own customers.

A successful SIPC claimant must demonstrate that he or she had funds or securities on deposit with a broker-dealer. For purposes of SIPC coverage, the value of a customer's claim is fixed at the date of filing for liquidation (in this instance, December 15, 2008). When possible, the actual stocks and other securities owned by customers will be returned to the customers. If necessary, SIPC reserve funds may be used to purchase replacement securities in the open market in order to accomplish this.

While we are still waiting for further instruction and information as to SIPC's scope of coverage with respect to the Madoff investments, particularly in light of the broad discretionary powers granted to authorities administering the securities and related laws such as SIPC and the SEC, funds that were being managed by Bernard Madoff's investment advisory business will most likely not be protected by SIPC, as SIPA was created to restore funds to customers of failed brokerage firms.

How Do Brokerage Customers Qualify for SIPC Protection?

The trustee typically will mail claim forms to customers of the firm, review their claims, and determine how to satisfy them using a combination of firm assets and SIPC funds. If you receive a claim form from the trustee, it is important to promptly complete and submit your form to the trustee so as not to miss any deadlines for submission.

Does SIPC Affect Customers who Withdrew Assets?

It is important to note that investors qualifying for recovery may be split into two groups—those who withdrew money and those who did not. Those investors who withdrew money that they had invested with the Madoff securities firm in recent years may have to return some or all of the funds. This concept stems from laws concerning "fraudulent conveyances," which require no proof of fraud but are intended to protect creditors and investors from a debtor's dissipation of assets. For example, in the case of another hedge fund, Bayou Group LLC, a federal court determined under fraudulent conveyance laws that certain investors who had pulled their money out of the firm (even some in years prior) had to return profits and, in some cases, initial investments, to offset losses of other investors.

As an additional matter, any distributions, however characterized, that were made in the 90 days prior to the bankruptcy filing of BMIS may be subject to return as a "preference" under the bankruptcy laws.

The amount of protection available to customers who withdrew assets may depend on many factors including the date(s) of such withdrawals, whether such customers had other funds at BMIS when the liquidation began, and the computation of those customers' overall losses.

Will SIPC Have Sufficient Assets?

The amount of SIPC coverage that investors will get for their losses in BMIS remains unclear. According to published reports, experts believe that SIPC might not have enough in its reserve to cover all potential claims. There is established authority for the SEC to borrow up to $1 billion from the Secretary of the Treasury and lend this money to SIPC in the event that the SIPC fund (currently estimated in published reports at approximately $1.5 billion) is insufficient to meet customer needs. But even with this additional loan from the SEC, SIPC may not be able to cover all valid claims.

What Avenues Might You Have for Coverage Beyond SIPC?

There may be arguments to be made that certain homeowner's or property insurance policies cover losses incurred in Madoff investments. Coverage differs from policy to policy, and you and your counsel should review all insurance policies that you have in order to determine if there are any claims to be made thereunder.

Are Tax Deductions Available?

While a tax discussion is beyond the scope of this letter, certain investors may be able to take advantage of certain tax benefits as a result of their losses. You are encouraged to seek tax advice with respect to your particular situation.

What Rights Do You Have in Any Class Action That Is Filed or Against Any Third Parties?

Class action cases attempt to assert rights of all investors who are similarly situated. We are aware of one such case that has been filed in the Madoff matter. In that case, the class is defined (for the most part) as "[a]ll persons and entities who purchased securities sold by or through defendants [Bernard L. Madoff] or BMIS, or other selling agents affiliated with Madoff or BMIS, from as early as the formation of BMIS in the 1960's until December 12, 2008 inclusive…." Whether a court will find that definition to be adequate is open to debate. If you fall within the definition of the class in a class action suit, there is nothing that you need to actively do to join the suit. We will continue to monitor the progress of the class action suit, but as of now, this and most other actions by investors to recover assets from BMIS will be stayed.

Claims against Madoff personally and other third parties that may be involved are not stayed, but are likely to be consolidated.

You may have claims against other third parties, such as investment advisors and auditors, which may be a potential source for recovery of losses as well.

What Should You Do Now?

According to published reports, the books and records of BMIS are not in good order. Therefore, it is essential that you gather all of your own records with respect to your Madoff investments (account opening documents, sales literature, statements, correspondence, copies of checks, etc.). You may be called upon to produce these documents as proof of investments and to qualify for SIPC coverage.

What Else Is Mintz Levin Doing Regarding Madoff?

Mintz Levin has formed a task force to investigate the various avenues of recovery and to advise clients. Our group consists of experienced attorneys from various sections of the firm spanning all relevant areas of law. We are exploring all possible claims that may be asserted by our clients to seek the largest possible recovery.

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

R. Robert Popeo
(617) 348-1716
RRPopeo@mintz.com

Kevin N. Ainsworth
(212) 692-6745
KAinsworth@mintz.com

Robert I. Bodian
(212) 692-6726
RBodian@mintz.com

Stephen J. Gulotta, Jr.
(212) 692-6769
SJGulotta@mintz.com

Stuart Hirshfield
(212) 692-6771
SHirshfield@mintz.com

Peter M. Miller
(617) 348-1726
PMMiller@mintz.com

Joel I. Papernik
(212) 692-6774
JIPapernik@mintz.com

Gilbert A. Samberg
(212) 692-6804
GASamberg@mintz.com