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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BEACON ASSOCIATES LLC I, BEACON
ASSOCIATES LLC II, ANDOVER ASSOCIATES,
L.P., ANDOVER ASSOCIATES LLC I, ANDOVER
ASSOCIATES (QP) LLC,

Plaintiffs

-vs-

BEACON ASSOCIATES MANAGEMENT CORP.,
ANDOVER ASSOCIATES MANAGEMENT CORP.,
INCOME PLUS INVESTMENT FUND, DAVID
FASTENBERG, TRUSTEE, LONG ISLAND
VITREO-RETINAL CONSULTANTS 401K FBO
DAVID FASTENBERG,

Defendants.

14-CIV-2294

**REPLY DECLARATION OF
MAX FOLKENFLIK**

I, Max Folkenflik, hereby declare:

1. As the Court is aware, I am a member of Folkenflik & McGerity LLP, counsel for Defendant David Fastenberg (“Fastenberg”), and I make this Reply Declaration in Further Support of Fastenberg’s motion, by Order to Show Cause, for a declaratory judgment and mandatory injunction, and in reply to the papers of the Income Plus Investment Fund

(“Income Plus”) which seek an order requiring all distributions to investors in the Beacon Funds¹ to be computed using the “Valuation Method.”

2. The Valuation Method calculates the proportional share of each investor in the net asset value of the Funds, which is calculated by adding contributions made and pro rata share of reported profits (including fictitious Madoff profits) and deducting withdrawals taken and pro rata share of reported losses. Income Plus argues that the Operating Agreement for the Beacon Funds provides for distribution to investors to be made on the basis of the Valuation Method. We do not quarrel with that assertion, and made the same argument in the prior proceedings with respect to the distribution of Non-Madoff money. The Court agreed.

3. We believe, however, that neither the force of the Operating Agreement by itself nor the fact of this Court’s prior decision require the Court to apply the Valuation Method to the distribution of Madoff money as Income Plus argues. We do not agree that it would be “unfair” to use the Net Investment Method for computing the distribution of Madoff Money. Use of the Valuation Method for those distributions avoids, rather than imposes, inequity.

The Proper Method of Distribution of Madoff Money Was Not Litigated And Has Not Yet Been Determined

4. Income Plus makes three points. First, Income Plus argues that the doctrine of collateral estoppel, or issue preclusion, applies and requires the application of the Valuation Method to the distribution of Madoff money. As Income Plus concedes, however, application of collateral estoppel requires that the issue decided in the prior proceeding be

¹ The Plaintiffs, Beacon Associates LLC I, Beacon Associates LLC II, Andover Associates L.P., Andover Associates LLC I, and Andover Associates LLC (QP) are hereinafter referred to collectively as the “Beacon Funds” or the “Funds”.

“identical” to the issue to be decided in the current proceeding, and despite the efforts of Income Plus to make it seem otherwise, the issues are entirely different.

5. The last proceeding was clearly directed only to Non-Madoff money, the cash remaining in the Beacon Funds which the Beacon Funds sought to distribute. I had been meeting and arguing for many months with Beacon Management’s counsel that they had to distribute those proceeds-- investors were desperate to get some of their money out of Beacon. Ultimately, Beacon Management commenced *Beacon Associates Management Corp. v. Beacon Associates LLC I*, No. 09-Civ.-6910, to resolve uncertainty regarding how to make *that distribution*. There was no effort to resolve any future disputes about future distributions. In particular, there was no attempt to address any future potential recovery of money from the Madoff Trustee. In my negotiations with the attorneys for the Beacon Funds and Beacon Management, I recall discussing that we needed to keep the issues as narrow as possible to get a quick determination that hopefully would not be appealed.

6. Income Plus makes much of the “fact” that the Beacon Funds had filed a claim in the BLMIS bankruptcy, and argues, therefore, that potential recovery from the BLMIS Estate was an “asset” of Beacon, subject to the arguments in the prior proceeding. However, the Beacon I audited financial statements for 2008, the then-most current audited financial statements, treated the \$358,710,309 investment in BLMIS as worth exactly zero. See, 2008 Audited Financial Statements (“2008 Statements”), annexed hereto as Exhibit A, at page 9, footnote 4. The only change in this approach in the years since 2008 has been to recognize money actually received by the Beacon Funds as cash, when received.

7. The initial dispute in this Court followed the analysis by Citrin Cooperman & Company LLP (“Citrin”) of three alternative methods of distribution to the Valuation Method

spelled out in the Operating Agreement. None of those methods focused on any recovery of money from the BLMIS Estate. The Net Investment alternative was never discussed. Counsel for the Beacon Funds sent a survey to each of the investors in the Beacon Funds in which he provided illustrative computations of their recoveries using each of the four alternative methods and specifying their exact recoveries under each method. The survey focused exclusively on the cash then being considered for distribution. Nothing in the survey indicated that the same results would apply to future recoveries from the BLMIS Estate, if any, and no mention was made of the Net Investment/Net Equity Method.

8. The Complaint seeking Declaratory Relief states in Paragraph 2, under the heading “Nature of the Action”: “Declaratory relief has been sought by BAMC [Beacon Associates Management Corp.] in this action, captioned *Beacon Associates Management Corp. v. Beacon Associates Management LLC I*, Civ. No. 09-CV-6910, in order to garner the Court’s imprimatur so as to resolve the question of the proper valuation methodology for distribution of each Beacon members’ residual capital accounts, comprised of non-Madoff invested monies.” Complaint, Exhibit A to Folkenflik Decl. 8/27/14, ¶ 2 (emphasis supplied).

9. When I filed my papers in support of the Fastenberg Intervenors’ motion for declaratory and mandatory injunctive relief, the Memorandum of Law stated:

On December 11, 2008, the date on which Madoff was arrested and confessed to his crimes, it was uncovered that from inception Madoff had been running a massive Ponzi scheme. As of the date of this Motion, all or substantially all of the money entrusted by investors to BLMIS has been lost, although hopefully there will be recoveries made in the future. In this motion the Fastenberg Intervenors are seeking to obtain distribution from Beacon I to them of the money currently held by Beacon I that was *not stolen*.

See, Fastenberg Intervenors' Memorandum of Law in Support of Motion for Judgment, at 2 [09 Civ. 6910, Docket No. 25] (emphasis in the original).

10. The money in dispute was really in three buckets: the cash available to be distributed; the amount of the "liquidation reserve"; and the money held in a segregated account pursuant to a standstill agreement between the Beacon Funds and the Trustee (about \$20 million), to preserve funds subject to the Trustee's "clawback claim" against the Beacon Funds. There were arguments in the papers and at oral argument which may have mentioned the future receipt of "Madoff money," or money from the Trustee, but the money then being referred to was the \$20 million in segregated funds. No one was litigating over money which might in the future be recovered from the BLMIS Estate.

11. At the oral argument where one investor, and my client, Jeffery Tolkin, argued for distribution on a Net Investment Method, I argued for the Valuation Method, and emphasized the fact that this was not "Madoff money." After the argument, I assured Mr. Tolkin that I recognized the different equities presented by the recovery of Madoff money, and for that reason would likely argue for a Net Investment Method when that issue ultimately presented itself.

12. When relief was finally granted by this Court, it held that "[a] mandatory injunction is granted directing Beacon's Management to distribute, by August 31, 2010, Beacon's remaining assets [less certain hold backs]..." *Beacon Assocs. Mgmt. Corp. v. Beacon Assocs. LLC I*, 725 F. Supp. 2d 451, 469 (S.D.N.Y. 2010). Everyone involved considered the phrase "remaining assets" to mean the cash assets then on hand. Any other interpretation would be inconsistent with the August 31, 2010 date. There was no

consideration given by the Court to cash assets which might be obtained in the future either from BLMIS or otherwise.

13. In short, as a matter of fact there were no claims made other than with respect to the cash on hand at the Beacon Funds available for distribution, or which could be in the future available for distribution. There was no actual litigation or determination with respect to the distribution in the future of Madoff Money which might be recovered from the BLMIS Estate or otherwise.

Applying the Valuation Method Will Further Result in Inequitable Distribution of Madoff Money

14. Second, Income Plus argues that the Net Investment Method is “unworkable and unfair,” but it does so by disregarding entirely the inequities which would be created if this Court applied the Valuation Method to the Madoff money distribution now at issue. The counsel for the Beacon Funds has distributed calculations and various computations to counsel for Income Plus and me concerning each of the investors’ net equity balances and net asset values in the Beacon Funds.³ Those computations show that using cash in/cash out from the Beacon Funds, there are currently 22 “net winners,” those who to date have received back more than they deposited into Beacon. *Those 22 investors already have recovered an aggregate of over \$13.5 million in profits.* If the Valuation Method were applied to the distribution of Madoff money as Income Plus is proposing, those would receive further distributions of nearly \$5 million, giving them *a total profit of \$18.5 million*, subsidized by

³ Those computations were submitted pursuant to a confidentiality stipulation but they may be submitted to the Court in camera, or under seal, should the Court wish.

approximately 212 other Beacon Fund Investors who will continue to have post-distribution aggregate losses in Beacon.⁴

15. There are many other investors, such as Income Plus, who are presently “net losers,” that is, they have not received back from Beacon their full investment in Beacon, but who will, unfairly we believe, receive from Madoff money a far greater percentage of their losses by the use of the Valuation Method than other investors who also have losses. Those investors would receive nearly \$6.5 million more in distributions using the Valuation Method than they would using the Net Investment Method. These computations do not include the 2013 distribution of approximately \$25million comprised of the distribution of the funds previously held back from the 2010 distribution to cover the Trustee’s “claw back” claim as well as further recoveries from Non-Madoff investment managers. That \$25 million was distributed based on the Valuation Method⁵. The money distributed on the Valuation Method to date substantially exceeds \$150 million.

The Valuation Method Distributions Give Long-Term Investors Substantial Benefits

16. Third, to the extent that these Valuation Method distributions did not get the Valuation Method proponents the entirety of their losses back, they got them very close, and far closer than they would have been if the Net Investment Method had been used for all distributions. The recoveries made from collateral sources were very substantial, and done on the basis of the Net Investment Method, but, significantly, these collateral source recoveries are not counted to reduce the recoveries from the BLMIS Estate or in calculating Net Equity

⁴ These amounts do not include collateral source recoveries for any investors of any amount, including the recoveries from the Bank of New York settlement which favored all Beacon investors other than the 22.

⁵ There was an additional \$2.8 million distributed in 2013, which was a recovery of management fees subject to the class action settlement and distributed by the Net Investment Method in accordance with the Court-Approved settlement.

for the purposes of the Beacon Fund Distributions and they often result in substantial profits being earned overall.

17. As a result of the interaction of these various factors, it is my estimation based on the numbers I have seen that many, if not all, of the long term investors *already have made profits on their Beacon Fund investments* and for most, they will get further distributions, and profits, even if the distribution of Beacon Madoff money is made under the Net Equity Method. They will also receive further distributions of Non-Madoff money which we believe should continue to be made on the basis of the Valuation Method. The use of the hybrid/blended approach does give the older investors a substantial benefit from the profits which they rightly made on the Non-Madoff money.

18. To take Income Plus as an example, Mr. Jeanneret informs the Court that, by using the Net Investment Method versus the Valuation Method, Income Plus would receive nearly \$700,000 from the current distribution and \$2.2 million less if the full amount of the BLMIS claim is ultimately paid and the Net Investment Method is used to compute Beacon Fund distributions than it would receive if the Valuation Method were used across the board. Jeanneret Decl. ¶¶ 11,12, 14.

19. Mr. Jeannerett fails to advise the Court that Income Plus' investors received millions of dollars in profits from the distribution in the BONY settlement. Those payments will not reduce future distributions from the Beacon Funds.

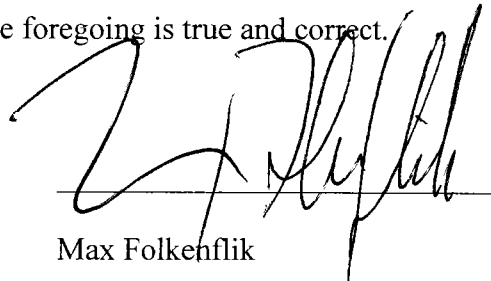
20. Similarly, Mr. Jeanneret cites the "extreme example" of the investor who will receive nothing if the BLMIS recovery is distributed on the Net Investment Method and over \$2 million if the Valuation Method is used. However he fails to mention that the investor in question already made a profit on the Beacon investments.

21. It is difficult, perhaps impossible, for the Court to ascertain with any certainty whether the profit which investors will make if the blended hybrid approach is used is somewhat lower than the theoretically perfectly calculated “net asset value” devised to eliminate all of the fictitious Madoff profits, or possibly even higher than the theoretical perfectly calculated non-Madoff “profit.” What is absolutely certain, however, is that imposition of the Valuation Method on the distribution of Madoff money will create the inequity of having some investors realize the benefit of fictitious profits at the direct expense of other investors.

22. To use the Valuation Method under these facts, would be to have some investors obtain fictitious profits at the expense of newer investors, or to have some investors who are still “net losers” recover a proportionately greater share of their loss as the expense of newer investors. Fastenberg seeks to avoid that iniquitous result.

I declare under penalty of perjury that the foregoing is true and correct.

Executed, in New York, New York,
September 5, 2014.



Max Folkenflik