

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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

*Plaintiffs,*

-vs.-

Civil Action No.  
1:14-cv-02294 (AJP)

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

*Defendants.*

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**REPLY MEMORANDUM OF DEFENDANT INCOME-PLUS  
INVESTMENT FUND RELATING TO CALCULATION OF NET  
EQUITY FOR CERTAIN INVESTORS**

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Defendant Income-Plus Investment Fund (“Income-Plus”) submits this Reply Memorandum of Law in further support of its position that, pursuant to the Court’s Final Distribution Order dated October 31, 2014 (Dkt. No. 51) (the “Distribution Order” or “Order”), the investment accounts of the Special Asset Liquidating Trust/formerly named AIJED Associates LLC (“AIJED I”) and AIJED International Ltd. (“AIJED II”) (collectively “AIJED”) should be combined for the purpose of applying the Net Equity Method set forth in the Order.<sup>1</sup>

AIJED argues that AIJED I and AIJED II should be treated separately because “there was no material overlap in the identifies of the investors” in the two entities. *AIJED’s Op. Br. p. 2*. The identities of the underlying investors in the two funds, however, is irrelevant, because the critical issue is whether AIJED I transferred fictitious profits to AIJED II. Because that is unquestionably what happened, AIJED II’s net equity must be adjusted to eliminate those fictitious profits.

The Court overseeing the liquidation of Bernard L Madoff Investment Securities LLC (“BLMIS”) considered – and rejected – the arguments that AIJED makes here. *See Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 522 B.R. 41 (Bankr. S.D.N.Y. 2014). In brief, the Court analyzed the appropriate methodology for computing the “net equity” in BLMIS customer accounts “where the balance in the account depends, to some extent, on amounts previously ‘transferred’ into that account from another

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<sup>1</sup> The parties have used different shorthand definitions for the two AIJED funds, which Income-Plus referred to in its Opening Brief as AIJED LTD and AIJED LLC. In turn, in the Memorandum in Support of AIJED International Ltd.’s Application for Release of Funds Due Pursuant to This Court’s Oct. 31, 2014 Order (“AIJED’s Op. Br.”), Dkt. No. 76, AIJED referred to AIJED LTD as AIJED and AIJED LLC as “Associates,” while Defendant David Fastenberg, in Defendant Fastenberg’s Memorandum of Law on Computation of Net Equity (“Fastenberg Op. Br.”), Dkt. No. 79, referred to AIJED LTD as “AIJED II” and AIJED LLC as “AIJED I.” In an effort to avoid confusion, Income-Plus will adopt the shorthand definitions used in Fastenberg’s Opening Brief and refer to the funds as AIJED I and AIJED II.

BLMIS account.” 522 B.R. at 46. After a detailed discussion regarding two other Madoff-related decisions (the *Net Equity Decision* and the *Antecedent Debt Decision*), the Court concluded that the adoption by the BLMIS Trustee<sup>2</sup> of the “Inter-Account Method” to determine net equity in transferred accounts was the most appropriate method. (Consistent with the nomenclature followed by the Bankruptcy Court in *Sec. Investor Prot. Corp. v. Bernard L Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 522 B.R. 41(Bankr. S.D.N.Y. 2014), this memorandum will refer to the most recent decision as the *Inter-Account Decision*.) The Inter-Account Method, as discussed in the *Inter-Account Decision* decision, is similar to the methodology followed by the Brattle Group and discussed in detail in Income-Plus’ Opening Brief. *Income-Plus Op. Br. pp. 3-4*. As a result, the *Inter-Account Decision* provides further support for applying the Brattle Group’s methodology to a determination of AIJED’s true net equity.

The Court in the *Inter-Account Decision* began its discussion by noting that, in reviewing customer claims, the “Trustee found numerous instances involving a transfer from one BLMIS customer account to another BLMIS customer account.” *Inter-Account Decision*, 522 B.R. at 49. That is the precise issue presented here – i.e., transfers from one Beacon Account (AIJED I) to another Beacon Account (AIJED II). The fact that the two accounts may have different names or even different investors is irrelevant; the focus is instead on the transfer of funds from one account to the next.

Presented with the transfers, the Trustee had to determine “the amount or value of the transfer[s] in order to fix the amount of the net equity in the transferee account[s].” *Inter-Account Decision*, 522 B.R. at 49. To do so, “the Trustee first recomputed the amount in the transferor

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<sup>2</sup> “Trustee” refers to Irving H. Picard, Trustee for the substantively consolidated liquidation of BLMIS under the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa et seq. (“SIPA”).

account at the time of the transfer under the Net Investment Method” and then “credited the transferee account in an amount up to the recomputed balance in the transferor account.” *Id.*

The Court explained the process with an example regarding a hypothetical transfer from customer A to customer B as follows:

[A]ssume that customer A’s account statement indicated a balance of \$5 million, but consisted entirely of fictitious profits. Customer B would not receive any benefit from an attempted transfer because customer A had \$0 balance in his account under the Net Investment Method at the time of the transfer.

*Inter-Account Decision*, 522 B.R. at 49. Here, AIJED II’s Beacon account was opened on July 1, 2005 with \$REDACTED transferred from AIJED I at a time when AIJED I’s net equity was only \$REDACTED, as can be seen from the following table, derived from Beacon’s records:

Date	Transaction	AIJED II	AIJED I	Relevant Beacon Notes
1997	Addition		REDACTED	
1998	Addition		REDACTED	
1999	Addition		REDACTED	
2000	Addition		REDACTED	
2001	Addition		REDACTED	
2002	Addition Withdrawal		REDACTED REDACTED	
2003	Withdrawal		REDACTED	\$ REDACTED Account Value
2004	Withdrawal		REDACTED	
<b><i>Interim Net Equity</i></b>			REDACTED	
2005	Addition /Transfer Withdrawal	REDACTED REDACTED	REDACTED REDACTED	7/1 transfer to open new acct
2006	Addition /Transfer Wthdrawal	REDACTED	REDACTED	Oct. 1 2006 withdrawal Oct. 1 2006 withdrawal
2007	Withdrawal	REDACTED	REDACTED	
2008	Addition /Transfer Withdrawal	REDACTED	REDACTED	Cash add: \$REDACTED on 7/1/08 7/1/08 cash withdrawal
<b><i>2008 Totals</i></b>		REDACTED	REDACTED	
2010	Non-Madoff Distrib.	REDACTED	REDACTED	
2013	Non-Madoff Distrib. Dist Ct Settlement Mgt Fee Settlement	REDACTED REDACTED REDACTED	REDACTED REDACTED REDACTED	

See Declaration of John P. Jeanneret, Ph.D. (“Jeanneret Dec.”) Ex. A. As set forth in the table above, AIJED I had a net equity of only \$REDACTED in 2005 when it transferred \$REDACTED to AIJED II. *Id.* The transfer therefore completely depleted AIJED I’s remaining net equity and utilized fictitious profits to fund the remainder of the amount transferred to open the account. Put another way, if not for the fictitious profits reported by BLMIS to Beacon, AIJED I would not have had sufficient assets in its Beacon account to make the transfer that it made to open the AIJED II.

Moreover, as the table above reveals, AIJED I continued to withdraw significant funds from Beacon up to the disclosure of Madoff’s fraud – and continued transferring at least some of those funds to AIJED II during the same time period. *See* Jeanneret Dec. Ex. A. For example, Beacon’s records reflect a \$REDACTED cash withdrawal from AIJED I on October 1, 2006 and a matching cash “contribution” of \$REDACTED to AIJED II on the *same day*. *Id.* All of that \$REDACTED withdrawal necessarily involved fictitious profits. Similarly, Beacon’s records for 2008 reflect a \$REDACTED cash withdrawal from AIJED I and a cash “contribution” of \$REDACTED to AIJED II, once again on the *same day* – this time July 1, 2008 – and once again involving the transfer of what must have been fictitious profits.

In the end, there can be little question that the “contributions” to AIJED II were only possible because of the substantial, fictitious profits earned by AIJED I from the time of its initial investment in 1997. In fact, Beacon’s records indicate that, as of 2003, AIJED I’s account value at Beacon was \$ REDACTED while its net equity as of that date was \$ REDACTED , meaning that the account as of that date contained over \$ REDACTED in fictitious profits.<sup>3</sup> Those fictitious

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<sup>3</sup> A further withdrawal of \$REDACTED in 2004 reduced AIJED I’s net equity to \$REDACTED.

profits must have been the source for the transfers from AIJED I to AIJED II because there is no record after the year 2002 of any additions into AIJED I's Beacon account.

The best method for eliminating the distorting effect the fictitious profits reported to AIJED I had on AIJED II's net equity position is to view the two related accounts as a single account. That was the approach identified by the Brattle Group and in fact followed in the settlement of the class action and related litigation, at least for all of the investors with which JPJA had experience. *Income-Plus Op. Br. pp. 4-5*. (It is unclear why the methodology was not followed for the two AIJED funds, but Income-Plus believes the oversight should not be compounded by continuing to treat the two AIJED funds as separate for net equity purposes in this proceeding.)

The Bankruptcy Court's reasoning in its decision approving the Inter-Account Method adds further support for the Brattle Group methodology. For example, in countering an argument that the Inter-Account Method elevated form over substance, the Court stated:

the true substance of transfers of fictitious profits from one account to another remains the same: The funds at issue are still other people's money, and shifting them among accounts, whether those accounts are owned by the same person or entity or, for example, transfers among family members, does not morph those funds into actual new principal..... *In other words, no new value was created by moving these funds between different accounts.*

*Inter-Account Decision*, 522 B.R. at 52 (emphasis added).

The Court further reasoned that:

A customer can't transfer what he doesn't have. The Inter-Account Method does not disturb or avoid the transfer; it merely determines the value of what was transferred based on the net investment in the transferor's account. The Net Investment Method approved by the Second Circuit is aimed at computing each customer's net equity by disregarding fictitious profits cooked up by Madoff and allocated arbitrarily. The Inter-Account Method ascribes the same zero value to the fictitious profits in the transferor's account that

the Net Investment Method ascribes to the fictitious profits in the transferee's accounts.

*Inter-Account Decision*, 522 B.R. at 53.

The Court was also influenced by its earlier *Antecedent Debt Decision*. See *Sec. Investor Prot. Corp. v. Bernard L Madoff Inv. Sec. LLC (In re Madoff)*, 499 B.R. 416 (Bankr. S.D.N.Y. 2013) – a decision that also dealt with transfers between customer accounts at BLMIS and concluded as follows: “at heart, the substance of these transactions was merely to perpetuate a cycle of artificial profits and further investments; where there was no investment of new principal, even those pre-reach-back-period transfers establishing new accounts failed to provide any new value.” *Id.* at 430.

In light of its analysis, the Court in the *Inter-Account Decision* concluded that, “like the Net Investment Method on which it is based, [the Inter-Account Method] nets all cash deposits to and withdrawals from the transferor's account, ignores the imaginary, fictitious profits that Madoff arbitrarily conferred on the transferors, and conserves the limited customer pool available to pay net equity claims on an equitable basis.” *Inter-Account Decision*, 522 B.R. at 53.

The *Inter-Account Decision* also rejected arguments by some BLMIS account holders who were deemed net losers as a result of transfers made to other beneficiaries of related accounts. *Inter-Account Decision*, 522 B.R. at 60-61. The account holders had argued, as AIJED does here, that the transferees' account history should have been treated separately from the transferors' account history for the purpose of determining their net equity. The Court categorized the argument as “another way of arguing that they should be treated as separate

customers.” *Id.* at 61. The Court went on to note that “[s]everal decisions have addressed the question and denied customer status to investors in an account that, in turn, invested in BLMIS.”<sup>4</sup>

For the reasons set forth in its Opening Brief and above, Income-Plus respectfully requests that the Court Order Beacon Associates LLC I and Beacon Associates LLC II to treat AIJED I and AIJED II as a single account for the purpose of calculating their net equity under the Distribution Order and distribute the funds held back to those investors with positive net equities.

**DATED:** March 23, 2014

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<sup>4</sup> Although the Court found that whether the account holders could have been considered separate under SIPA was beyond the scope of the motion, the decisions referenced by the Court make clear that customer status is determined at the fund level and not, as AIJED seeks to argue, by reference to the investors in the different funds. *See, e.g., Kruse v. Sec. Investor Prot. Corp (In re Bernard L. Madoff Inv. Sec. LLC)*, 708 F.3d 422, 426-27 (2d Cir. 2013) (investors in feeder funds that invested in BLMIS were not customers of BLMIS).

**CERTIFICATE OF SERVICE**

I hereby certify that on March 12, 2015, I electronically filed the foregoing Memorandum of Defendant Income-Plus Investment Fund in Support of Motion to Stay using the CM/ECF system, which sent electronic or other notification of such filing to all counsel of record in this case, and a copy was also sent by first class mail to all counsel of record.

/s/ Brian E. Whiteley  
**BRIAN E. WHITELEY**