



# SECURITIES ALERT

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*Federal Appeals Court in New York Approves Picard's Calculation Method, Disappointing So-Called "Net Winners"*

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In a decision that was not surprising but nevertheless disappointing, the U.S. Court of Appeals for the Second Circuit recently affirmed the order of the U.S. Bankruptcy Court concluding that the “net equity” calculation for distributions back to Madoff victims should be based on the Net Investment Method, the total of actual deposits and withdrawals, and not the last statement amount listed on the final brokerage account statement. As a result, claw back law suits against the inaptly named “net winners” are sure to continue unabated.

**Background**

In the Madoff SIPC proceeding, Irving Picard, the SIPA Trustee, determined that each customer’s “net equity” should be calculated by the “Net Investment Method,” crediting the amount of cash deposited by the customer into his or her Bernard L. Madoff Investment Securities LLC (“BLMIS”) account, less any amounts withdrawn from it. The use of the Net Investment Method limits the class of customers who have allowable claims against the customer property fund—people entitled to repayments of recovered funds—to those customers who deposited more cash into their investment accounts than they withdrew, because only those customers have positive “net equity” under that method. Some of the former customers objected to the Trustee’s method of calculating “net equity” and argued that they were entitled to recover the market value of the securities reflected on their last BLMIS customer statements (the “Last Statement Method”). They argued, among other things, that the Last Statement Method is mandated by the SIPA law, that they had a legitimate expectation that their customer account statements were accurate, and that SIPA is designed to protect this legitimate expectation.

The Bankruptcy Court agreed with Mr. Picard’s method, but certified its order in favor of the Trustee permitting an immediate appeal to the Second Circuit. Both sides agreed in a letter to the Bankruptcy Judge that “the entry of a final, nonappealable order regarding the net equity dispute will provide finality and closure to those who were victimized as a result of Madoff’s fraudulent scheme.”

**The Second Circuit Decision**

In its decision, the Second Circuit concluded that the language of the SIPA statute does not “prescribe a single means of calculating ‘net equity’ that applies in the myriad circumstances that may arise in a SIPA liquidation.” Rather, the Court concluded that “Mr. Picard’s selection of the Net Investment Method was more consistent with the statutory definition of ‘net equity’ than any other method advocated by the parties or perceived by this Court. There was therefore no error.”

Explaining its rejection of the Last Statement Method, the Court wrote, “Use of the Last Statement Method in this case would have the absurd effect of treating fictitious and arbitrarily assigned paper profits as real and would give legal effect to Madoff’s



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machinations.” In addition, it would “reward those who had already withdrawn cash deriving from imaginary profits in excess of their initial investment,” and such customers would “derive additional benefit at the expense of those customers who had not withdrawn funds before the fraud was exposed.” The Court concluded, “Because the main purpose of determining ‘net equity’ is to achieve a fair allocation of the available resources among the customers, the Trustee properly rejected the Last Statement Method as it would have undermined this objective.”

For all the BLMIS customers, the Court included a ray of hope that investors may be entitled to an adjustment for interest or inflation, an issue that has not yet been addressed by the Bankruptcy Court. The Court noted that “[w]e express no view on whether the Net Investment Method should be adjusted to account for inflation or interest, an issue on which the bankruptcy court has not yet ruled and which is not before us on this interlocutory appeal.”

### Conclusion

Although a disappointing result for the “net winners,” the Second Circuit’s decision provides additional guidance for all parties. As a result, defendants in the claw back suits now have greater clarity regarding the applicable rules to help inform their litigation decisions.

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