

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

BEACON ASSOCIATES LLC I, BEACON  
ASSOCIATES LLC II, ANDOVER  
ASSOCIATES LLC I, ANDOVER  
ASSOCIATES (q) 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, ET AL.,

*Defendants.*

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

**MEMORANDUM IN SUPPORT OF AIJED INTERNATIONAL LTD.'S  
APPLICATION FOR RELEASE OF FUNDS DUE PURSUANT TO  
THIS COURT'S OCT. 31, 2014 ORDER**

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AIJED International, Ltd. (“AIJED”), an investor in Beacon, respectfully asks this Court to release to AIJED amounts due to it pursuant to this Court’s October 31, 2014 final distribution order (the “Order”) that were temporarily held back from distribution by Beacon pending the outcome of this dispute.<sup>1</sup>

### **PRELIMINARY STATEMENT**

AIJED respectfully submits that it is entitled to a current further distribution from Beacon of approximately [REDACTED]. Under the plain terms of the Order, Beacon is required to distribute a proportional share of available cash to any investor whose contributions to Beacon exceeded that investor’s withdrawals from Beacon – i.e., any investor with positive “Net Equity” in Beacon. In January 2015, Beacon distributed tens of millions of dollars to investors (the “January Distribution”).

At the time of the January Distribution, according to Beacon itself, AIJED had positive Net Equity of [REDACTED]. Indeed, on or around November 6, 2014, Beacon advised AIJED that it was entitled to a distribution of approximately [REDACTED] based on AIJED’s substantial Net Equity. *Beacon’s conclusion that AIJED has positive Net Equity of [REDACTED] never changed prior to commencement of this proceeding.* Nevertheless, Beacon provisionally withheld AIJED’s distribution so that this Court can consider and resolve objections to AIJED’s right to payment raised by certain other Beacon investors (the “Challenging Investors”). In addition, Beacon held back approximately \$ [REDACTED] that would otherwise be due to [REDACTED] other Beacon investors (the other “Holdback Investors”), all of whom are situated differently than AIJED.

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<sup>1</sup> “Beacon” refers collectively to Beacon Associates LLC I (“Beacon I”) and Beacon Associates LLC II (“Beacon II”). Beacon II is a passive investor in Beacon I. *See Beacon Assocs. Mgmt. Corp. v. Beacon Assocs. LLC I*, 725 F. Supp. 2d 451, 453 n. 2 (S.D.N.Y. 2010). Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Order.

The Challenging Investors' contentions have shifted since the time of their original objection in mid-November. Initially, the Challenging Investors agreed with Beacon that AIJED has ██████████ in positive Net Equity, but argued that AIJED's positive Net Equity should be offset by net withdrawals made from a different account at Beacon by an affiliated, but different investment fund called AIJED Associates LLC ("Associates"). However, as applied to AIJED, the Challenging Investors' "netting" proposal is both contrary to the Order and manifestly inequitable.

The Order – which the Challenging Investors were closely involved in drafting – expressly requires that Net Equity be determined by subtracting each individual investor's withdrawals from Beacon from that individual investor's contributions to Beacon. Since AIJED and Associates are different investor entities with different Beacon accounts that made different contributions and withdrawals to Beacon at different times, the amount of their respective Net Equity should be calculated separately.

Crucially, moreover, from the time of AIJED's formation through the discovery of the Madoff fraud, there was no material overlap in the identities of the investors in AIJED and the investors in Associates. This is a crucial distinction between AIJED and the other Holdback Investors. Each of the other Holdback Investors had more than one account with Beacon, and made contributions and withdrawals from both accounts. It therefore made sense to "net" the two accounts against one another, because the same individual investor – and only that investor – made all deposits and all withdrawals from both accounts.

In contrast, the two accounts at issue here are owned by different investors – AIJED on the one hand, and Associates on the other – and those two entities in turn have different investor-beneficiaries. Hence, the persons that contributed cash to AIJED (which AIJED in turn

contributed to Beacon) are different than the persons that withdrew cash from Associates (and which Associates in turn withdrew from Beacon). It would be unfair to prejudice AIJED's investors based on withdrawals from Beacon made by a different fund from a different account, for the benefit of an entirely different investor base, just as it would be inequitable to reward Associates for contributions made to Beacon from funds provided by AIJED's investors to Beacon through AIJED's separate account.

Since learning that AIJED and Associates are two truly distinct entities – both formally and substantively – the Challenging Investors appear to have shifted the focus of their objection. Although we understand the Challenging Investors did not previously object to Beacon's calculation of AIJED's Net Equity, now they do. Specifically, the Challenging Investors now argue that the Court should reduce the amount credited by Beacon to AIJED in connection with AIJED's initial investment, and allocate most of that reduced amount back to Associates, even though Associates has not sought such a reallocation.

The Challenging Investors' last-minute proposed accounting gerrymander should be rejected. First, AIJED's initial investment in Beacon should not be capped or otherwise reduced. In or around June 2005, investors in Associates redeemed and withdrew their investment and reinvested those amounts in AIJED. For its own administrative convenience, Beacon booked AIJED's initial contribution to Beacon in 2005 as a transfer from Associates, but substantively the transaction constituted a new investment in Beacon by a new investor, and Beacon correctly credited the full amount of that investment to AIJED (and debited the full amount of the corresponding redemption against Associates). AIJED's Net Equity position should not be prejudiced merely because its members chose not to insist on a cash wire out of Beacon.

Second, Beacon should not be required to reallocate any portion of the amount credited to AIJED back to Associates. The Order directs Beacon to determine the Net Equity contributed by *Beacon's* investors; the Order makes no mention of further allocating Net Equity among such investors constituent members using an arbitrary “ratio” like the Challenging Investors now propose. Significantly, when the Challenging Investors negotiated the terms of the Order, they knew that there were many hedge funds and other partnerships, limited liability companies and associations invested in Beacon, and specifically knew every detail concerning AIJED’s and Associates’ respective contributions and withdrawals to Beacon.

Nevertheless, the Challenging Investors never sought to add a provision to the Order applying a “ratio” – or any other methodology, for that matter – further apportioning Net Equity based up on guestimates of contributions by Beacon investors’ constituent members, and should not be permitted to graft such a provision onto the Order now. Indeed, if the Challenging Investors succeed now in implementing a ratio approach to allocating Net Equity among related investors, fairness would dictate a thorough reexamination of Net Equity credited by Beacon to *all* of its investors, not just AIJED. AIJED submits, however, that Beacon’s original calculation of Net Equity for AIJED should not be disturbed, and that the Challenging Investors’ “reallocation” proposal should be rejected.

### **STATEMENT OF FACTS**

#### **A. Formation of Associates; Investment in Beacon; Formation of AIJED**

Associates was organized as a New York limited liability company in 1997, pursuant to an Operating Agreement dated February 4, 1997 and amended and restated as of May 15, 2007. Declaration of Arthur S. Gordon (“Gordon Decl.”) ¶ 2. Gordon Asset Management LLC (“GAM”) was Associate’s managing member. Gordon Decl. ¶ 2. Membership interests in Associates were offered to investors in a confidential Private Placement Memorandum

(“Memorandum”) dated February 1, 1997 and amended and restated as of May 15, 2007. *Id.* As a “fund of funds,” Associates invested its members’ capital in a portfolio of other investment funds, including Beacon. *Id.* ¶ 3. In turn, Beacon invested in Bernard L. Madoff Investment Securities LLC (“BLMIS”).<sup>2</sup> *Id.*

In June 2005, AIJED was formed as a Cayman Islands exempted company operating under its own Memorandum and Articles of Association, with GAM acting as AIJED’s investment manager. *Id.* ¶ 4. AIJED was controlled by a board of directors with a majority of board members who were independent of AIJED, Associates and GAM. Gordon Decl. ¶ 4. As an offshore corporation, AIJED offered certain tax benefits to U.S. tax-exempt investors (e.g., IRA accounts and institutional investors). *Id.* ¶ 5. In order to benefit from such tax advantages, █ of Associates’ approximately █ members redeemed their investment in Associates in June, 2005 and reinvested in AIJED. *Id.* Approximately █ investors remained with Associates, which in turn remained an investor in Beacon through discovery of the Madoff fraud in 2008. *Id.* During the period between the creation of AIJED in mid-2005 and the discovery of the Madoff fraud in December 2008, AIJED’s and Associates’ investor lists were continually changing as investors redeemed funds and new investors purchased subscriptions. *Id.* ¶ 6.

In total, █ was redeemed from Associates and reinvested in AIJED between June 30, 2005 and November 1, 2005. Gordon Decl. ¶ 7. Of that amount, █ was from Associates’ Beacon investment, with the remainder coming from Associates’ investments in other funds. *Id.* Most of the money subject to redemption – █ – was redeemed from Associates by the withdrawing investors on June 30, 2005 and reinvested in AIJED on July 1,

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<sup>2</sup> At the time of Associates’ initial investment in 1997, Beacon’s capital was 100% invested in BLMIS. Beginning in or around 1999, Beacon diversified, adding a number of other investments to its portfolio, and reducing its exposure to BLMIS to as little as 70%. As discussed in more detail below, Associates, and later AIJED, instructed Beacon to put their cash contributions into BLMIS, and thus had greater exposure to Madoff than any other Beacon investors. Gordon Decl. ¶ 20.

2005, with a small balance retained as a “holdback” pending final net asset value calculations from the various funds in which Associates was invested. *Id.* ¶ 8. That holdback (approximately [REDACTED]) was distributed by Associates and reinvested in AIJED by the withdrawing investors between July 31, 2005 and September 1, 2005.<sup>3</sup> *Id.* None of the [REDACTED] investors who departed for AIJED remained an investor in Associates after their withdrawal from Associates was complete. *Id.* ¶ 9. Hence, at no time during the existence of the two funds was there any material overlap between the investors in AIJED and the investors in Associates. *Id.* ¶ 10.

At the time of the redemptions, Associates’ portfolio was comprised exclusively of funds organized under U.S. law, but many of those funds had offshore fund entities pursuing substantially the same strategy as their onshore affiliate. *Id.* ¶ 12. When Associates withdrew part of its investments in these U.S.-based funds to carry out the mid-2005 distributions to the [REDACTED] departing investors, funds with offshore affiliates generally wired the amounts necessary to satisfy the redemptions to Associates, and those sums in turn were wired by AIJED to the offshore affiliate. *Id.*

Unlike these other funds, Beacon did not have an offshore affiliate pursuing substantially the same strategy as Beacon. *Id.* ¶ 13. Hence, as an administrative convenience, in lieu of wiring cash out to Associates and awaiting a cash wire back in the same amount from AIJED, Beacon identified the transaction on its own books as a “transfer” of [REDACTED] from Associate’s Beacon account to AIJED’s separate Beacon account. *Id.*; While neither fund insisted on Beacon providing a cash wire, GAM made clear to Beacon that the “transaction shall be deemed a withdrawal by [Associates] of [REDACTED] from its capital account and an investment by [AIJED] in [Beacon] in the same amount.” Gordon Decl. Ex. A.

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<sup>3</sup> In addition, three withdrawing Associates investors (included in the [REDACTED] total withdrawing investors) began their redemptions slightly later, on August 31, 2005 and September 30, 2005, respectively. These three investors’ total investment (approximately [REDACTED]) was fully invested in AIJED by November 1, 2005.

Accordingly, the 2005 K-1 issued by Beacon to AIJED identified the [REDACTED] investment as “capital contributed during the year,” while Beacon’s K-1 for Associates included that amount among its “withdrawals and distributions” during 2005. Gordon Decl. ¶ 15. Similarly, Associates’ K-1s to its own investors reported the amounts they redeemed in or around July 2005 as “withdrawals and distributions.” *Id.* ¶ 16. As recently as November 6, 2014, Beacon again acknowledged in correspondence with the Challenging Investors that what Beacon called a “transfer” from Associates to AIJED in 2005 was “to be treated as a withdrawal and NEW investment.” Declaration of Mitchell P. Hurley (“Hurley Decl.”) Ex. 10 (capitalization in original).

During the years after AIJED’s initial Beacon investment in 2005, AIJED received approximately [REDACTED] from new investors – including over [REDACTED] in 2008 alone – and contributed an additional [REDACTED] in capital to Beacon, while withdrawing just [REDACTED] Gordon Decl. ¶ 17; Hurley Decl. Ex. F. AIJED’s contributions to Beacon were funded by AIJED’s investors only, and did not come from any other sources. *Id.* ¶ 17. During the same period, Associates and its investors took out about [REDACTED] from Beacon [REDACTED] [REDACTED] *Id.* ¶ 18; Hurley Decl. Ex. F. The moneys distributed to Associates during this period benefited only Associates investors, none of whom were also material investors in AIJED. Gordon Decl. ¶ 18.

**B. 2010 Distributions, Brattle Group Review and 2013 Distributions**

Beacon was primarily, but not exclusively, invested in BLMIS. *Id.* ¶ 20. Hence, after the Madoff fraud was discovered in 2008, Beacon had some “non-Madoff” assets available for distribution to Beacon’s investors, including Beacon’s interests in funds other than BLMIS, as well as some cash. *Id.* ¶ 25. In 2010 and 2013, Beacon distributed the value of those “non-Madoff” assets in accordance with the “valuation method” pursuant to this Court’s order dated

July 27, 2010 (the “Non-Madoff Distributions”). *Beacon Assocs. Mgmt. Corp. v. Beacon Assocs. LLC I*, 725 F. Supp. 2d 451 (S.D.N.Y. 2010). In addition, investors in Beacon were the beneficiaries of a substantial settlement of certain class actions and other Madoff-related litigation. Gordon Decl. ¶ 26. The proceeds of the settlement were distributed to Beacon investors based on the Net Equity method pursuant to a plan of allocation that was approved by Judge Colleen McMahon in 2013, and administered by the Brattle Group (the “Settlement Distributions”). *Id.*; *In re Beacon Assocs. Litig.*, 2013 WL 2450960 (S.D.N.Y. 2013); Case No. 1:09-cv-03907-CM-AJP, ECF No. 308, Ex. A.

**C. 2014 Dispute Regarding Distribution Methodology and October 31 Order**

Due to the Madoff trustee’s success in collecting assets for the BLMIS estate, tens of millions of additional dollars have flowed into Beacon since the 2010 Distributions and the Settlement Distributions were made. Compl. ¶¶ 8-9. In 2014, a dispute arose among Beacon investors – including the Challenging Investors, as well as other investors represented by Max Folkenflik and Brian Whiteley, respectively – concerning whether such assets should be distributed pursuant to the Valuation Method, or pursuant to the Net Equity method. *Id.* ¶ 11.

At a hearing on October 7, 2014, the Court ruled that distributions should be made using the Net Equity method, and asked the parties to jointly prepare a detailed order to that effect. ECF No. 43 (Oct. 7, 2014 Tr., 44:13-18; 46:20-47:2). Three weeks later, following extensive negotiations among Beacon, Mr. Folkenflik, Mr. Whiteley and others, Beacon submitted a proposed Order to the Court. Hurley Decl. Exs. A, I. According to Beacon’s October 31, 2014 cover letter, the Order constituted “a very detailed and methodical road map for [Beacon] to follow in connection with future distributions . . . and resulted from effort by [Beacon] to work with all the parties in this litigation . . . to reach a consensus of what is fair and equitable for all

investors consistent with this Court’s October 7, 2014 ruling.” *Id.* Ex. I at 4. Upon information and belief, the Court entered the Order without modification. *Id.* Ex. A.

At the time they negotiated the terms of the Order, the Challenging Investors knew the timing and amounts of all contributions and withdrawals made by AIJED and Associates, respectively, and knew that both Beacon and the Brattle Group had calculated Net Equity for those two funds separately. Hurley Decl. ¶ 3; *see generally*, ECF No. 65 (Feb. 25, 2015 Tr.) In addition, to aid the negotiations, Beacon “ran numerous calculations showing the parties how changing various components of the distribution algorithm would affect different investors.” Hurley Decl. Ex. I at 4. Armed with this extensive information, the Challenging Investors and all other parties agreed, among other things, that Net Equity should be calculated on an investor-by-investor basis:

[Beacon] shall compute *each investor’s* remaining unpaid investment in [Beacon] based upon *each investor’s* total cash contributions and subtract any cash distributions or withdrawals to *that investor . . .* resulting in *the investor’s* remaining “Net Equity.” The total Net Equity of *each investor* in [Beacon] is then divided into the total remaining Net Equity of all investors in [Beacon] to calculate *the investor’s* “Net Equity Sharing Ratio” in [Beacon].

Hurley Decl. Ex. A at 5 (emphasis added). The Order is final and cannot be appealed.

**D. Beacon Calculation of Respective Net Equity for AIJED and Associates**

Prior to initiating this proceeding on or around January 14, 2015, Beacon created several iterations of spreadsheets calculating Net Equity for AIJED and Associates. In each such spreadsheet, Beacon separately identified the withdrawals and contributions made to and from the Beacon accounts of each of AIJED and Associates, and concluded that AIJED had positive Net Equity of more than \$ [REDACTED]. *See, e.g.*, Hurley Decl. Ex. F; Gordon Decl. Ex. B. The substance of Beacon’s spreadsheet calculations are reproduced for ease of reference below, with withdrawals indicated in parentheses:

<u>Year</u>	<u>AIJED Int'l Ltd.</u>	<u>AIJED Associates</u> <sup>4</sup>
1997		[REDACTED] 0
1998		[REDACTED]
1999		[REDACTED]
2000		[REDACTED]
2001		[REDACTED]
2002		[REDACTED]
2003		[REDACTED]
2004		[REDACTED]
<b>2005</b>	[REDACTED]	[REDACTED]
2006	[REDACTED]	[REDACTED]
2007	[REDACTED]	[REDACTED]
2008	[REDACTED]	[REDACTED]
<b>Subtotal</b>	[REDACTED]	[REDACTED]
2010 (Non-Madoff)	[REDACTED]	[REDACTED]
2013 (Non-Madoff)	[REDACTED]	[REDACTED]
(Settlement)	[REDACTED]	[REDACTED]
(Settlement)	[REDACTED]	[REDACTED]
<b>Total Remaining Net Equity</b>	[REDACTED]	[REDACTED]

*Id.*

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<sup>4</sup> Certain of the spreadsheets make reference to AIJED Associates QP (“QP”), organized in 2008, and the Special Asset Liquidating Trust (“SALT”), created later in 2008 after discovery of the Madoff fraud. It is undisputed that QP and Salt should be treated as continuations of Associates for purposes of calculating Net Equity in Beacon. Under Section 3(c)(1) of the Investment Advisors Act of 1940, as amended (the “Company Act”) Associates was allowed to have only 100 members. Gordon Decl. ¶ 2 n.1. In 2008, GAM sought to accommodate additional investor interest by creating QP, which could have an unlimited number of members as long as they were “qualified purchasers.” *Id.* Associates became a member of QP, along with other qualified purchasers, which succeeded to all of Associates’ assets, including Associates’ interest in Beacon and other funds. *Id.* After the Madoff fraud was discovered in December 2008, the SALT was created to hold QP’s interests in Beacon. *Id.* Hence, there is no practical need to distinguish between Associates, QP and SALT for purposes of calculating Net Equity.

<sup>5</sup> Unlike all other Beacon investors, both AIJED’s account and Associates’ account were invested solely in BLMIS. The small “non-Madoff” distribution to AIJED and Associates represents the portions of their respective Madoff accounts that were held in cash when the fraud was discovered in 2008.

<sup>6</sup> A small part of the Settlement proceeds was split among all Beacon investors, regardless of whether the investor had positive Net Equity. Hence, Associates received a small distribution, despite the fact that it had previously withdrawn more from Beacon than it contributed.

In every one of Beacon's pre-dispute Net Equity calculations – including the calculations Beacon ran after the Challenging Investors argued for “netting” – Beacon concluded that AIJED has positive Net Equity equal to \$ [REDACTED] *Id.* Based on this conclusion, on or around November 6, 2014, Beacon advised AIJED it was entitled to a current distribution of approximately [REDACTED] million. Gordon Decl. ¶ A.

**E. Brattle Group Analysis Leads to Netting Other Holdback Investor Accounts**

In connection with the Settlement Distributions, the Brattle Group analyzed data provided by Beacon identifying the contributions and withdrawals made by each of Beacon's investors. Hurley Decl. Ex. B, at 1. In addition, representatives of the Brattle Group met with Beacon and counsel for the Challenging Investors – including Mr. Folkenflik, among others – to consider how Net Equity should be calculated with respect to Beacon's investors. Hurley Decl. ¶ 3.

The Brattle Group identified a number of Beacon accounts that Brattle determined should have been “netted” against other accounts owned by the same investors. Hurley Decl. Ex. B, at 1. Each of the investors identified by the Brattle Group had previously invested in Beacon through a separate individual account, or [REDACTED]. Hurley Decl. Ex. B, at 1; *Id.* Ex. D; *Id.*, Ex. E. After closing their former accounts, each of the investors reopened a new individual account directly with Beacon. Hurley Decl. Ex. B, at 1; *Id.* Ex. D; *Id.*, Ex. E. The Brattle Group concluded that contributions and withdrawals made into Beacon accounts *owned by the same investor* should be netted against one another. Hurley Decl. Ex. A, at 1; *Id.* Ex. D; *Id.*, Ex. E. Upon information and belief, Brattle also reviewed Beacon's calculations of net equity for AIJED and Associates, and specifically agreed with Beacon that those accounts – *which were not owned by the same investor* – should not be netted against one another. Hurley Decl. Ex. B, at 1.

Beacon later identified additional investors situated similarly to the investors originally identified by the Brattle Group, in that each made contributions and withdrawals from more than one Beacon account, and determined to net those accounts against one another. Hurley Decl. Ex. B, at 1. Most of these seventeen investors – previously defined as the other “Holdback Investors” – are represented by Mr. Folkenflik.

**F. The Challenging Investors Argue that AIJED’s Positive Net Equity should be further “Netted” against Associates’ Negative Net Equity**

At some point after November 6, 2014 (presumably), the Challenging Investors contacted Beacon and argued that the account owned by AIJED should be netted against the account owned by Associates. At the Challenging Investors’ request, Beacon re-ran its Net Equity spreadsheet for AIJED and Associates, this time adding a column that “combined” AIJED’s positive Net Equity with Associates’ negative Net Equity. Gordon Decl. Ex. B. Significantly, even with the revisions urged by the Challenging Investors, Beacon *continued to calculate AIJED’s “Total Remaining Net Equity – Nov. 2013” as* [REDACTED]. (final row, first page).

At the time they first asked Beacon to “combine” AIJED’s account with Associates’ account, AIJED believes the Challenging Investors may have been unaware that AIJED and Associates were truly distinct entities with different investors. AIJED has since produced detailed records identifying the investors in AIJED, the investors in Associates, and the months and amounts of the contributions and withdrawals of those investors from the two funds. Gordon Decl. ¶ 19. AIJED also made GAM’s principals available for a telephonic interview with Mr. Folkenflik, per his request at the February 25, 2015 hearing. (Tr. at 13:19-24.) AIJED believes that the Challenging Investors are now satisfied that there never were any investors in AIJED that were at the same time material investors in Associates. AIJED is unsure whether any of the

Challenging Investors will continue to advocate netting AIJED's account against Associates' account.

At a minimum, the Challenging Investors seem to have refocused their objection. Now they argue that the calculations contained in Beacon's November 17, 2014 revised spreadsheet – a spreadsheet that was prepared by Beacon at the Challenging Investors' urging – should be further revised by reducing and reallocating AIJED's Net Equity so that AIJED will get no further distribution from Beacon even if the Challenging Investors' original "netting" proposal is rejected. The Challenging Investors' latest theory is as meritless as their original theory, and both should be rejected.

### **ARGUMENT**

#### **I. ONLY ACCOUNTS OWNED BY THE SAME INVESTOR SHOULD BE NETTED**

The Order clearly provides that Net Equity calculations should be performed by netting "each investor's" contributions against withdrawals to "that investor." Hurley Decl. Ex. A at 5. That is exactly what Beacon proposes to do with the other Holdback Investors: each such investor's withdrawals from Beacon will be subtracted from that investor's contributions to Beacon, even though the investor owned more than one Beacon account.

In contrast, netting AIJED's contributions and withdrawals against Associates' contributions and withdrawals violates the plain terms of the Order because the two funds are separate investors. As discussed above, counsel for the Challenging Investors were intimately involved in crafting the terms of the Order, and were aware that related hedge funds were investors in Beacon. If the Challenging Investors believed that separate accounts of different investors should be netted against one another simply because the investors belong to the same complex of funds, or have similar sounding names, the Challenging Investors should have sought to include a provision to that effect in the Order. Any such proposal could then have been vetted

by all parties and by the Court and – if adopted – applied equally to all investors. But the Challenging Investors made no such proposal, and instead agreed that Net Equity should be calculated on an investor-by-investor basis in all cases.

In any event, it would make no sense to net contributions made by one pooled investment fund against withdrawals made by another simply because the two funds are affiliated, as the facts of this dispute perfectly illustrate. AIJED and Associates are legally distinct entities with different investor bases. AIJED's members should not be punished for distributions made by Beacon to Associates that benefited only Associates' members, and Associates' members should not be rewarded for contributions made by AIJED to Beacon at the sole expense of AIJED's entirely different membership. The Challenging Investor's ill-conceived bid to net these separate accounts against each other must be rejected.

## **II. BEACON'S CALCULATION OF NET EQUITY SHOULD NOT BE DISTURBED**

The Challenging Investors never objected to Beacon's calculation of AIJED's Net Equity until they learned that AIJED and Associates have different investors, and that AIJED's positive Net Equity therefore cannot fairly be netted against Associates' negative Net Equity. Since that realization, the Challenging Investors have shifted the focus of their objection, and now argue that AIJED's Net Equity should be reduced below the [REDACTED] in Net Equity that Beacon has consistently calculated for AIJED.

In order to reach the outcome they desire, the Challenging Investors argue that AIJED should receive only partial credit for the amount of AIJED's initial investment in Beacon in June 2005. As illustrated in the chart at page 10, above, when Beacon calculated AIJED's and Associates' Net Equity, it booked the entirety of the [REDACTED] million face amount of Associates' 2005 withdrawals as a debit against Associates' Beacon account, and credited the same amount to AIJED's Beacon account as a contribution.

The Challenging Investors argue that Beacon should have credited AIJED with no more than [REDACTED] which they contend is the amount of net cash contributed to Beacon by Associates at the time of the June 2005 redemption, withdrawal and reinvestment. (Feb. 25, 2015 Tr. at 12 (arguing that “it might be that you allocate all [REDACTED] [AIJED], and then [AIJED] received a certain amount of cash profits, not a large number . . . that should be deducted” from the [REDACTED] that Beacon credited to AIJED).) Not satisfied with this proposed reduction in AIJED’s Net Equity, the Challenging Investors apparently will now argue that AIJED’s investment should not only be capped, but that most of that investment should be “reallocated” back to Associates. Neither contention has merit.

**A. AIJED’s Net Equity should not be Reduced**

The Challenging Investors’ proposal to reduce the amount of AIJED’s June 2005 investment in Beacon for Net Equity purposes should be rejected. Substantively, the June 2005 redemptions from Associates were indistinguishable from a cash withdrawal by the departing investors of [REDACTED], and reinvestment of [REDACTED] of that cash in Beacon through AIJED. The redeeming investors could have used the redeemed funds to pay tuition, cancel debt, invest in other securities, or for any other purpose they wished. Instead, they reinvested those amounts in AIJED, thus providing millions of additional dollars to satisfy claims of other Beacon investors after the Madoff fraud was discovered. AIJED’s Net Equity position should not be prejudiced merely because its investors chose not to insist on receiving cash wire transfers when they withdrew from Associates.

Crediting AIJED with the full amount of its [REDACTED] initial investment is also justified because AIJED and Associates had greater exposure to Madoff than did any of Beacon’s other investors. For most of Beacon’s existence, it invested as little as 70% of its capital in BLMIS. Hence, when ordinary investors contributed funds to Beacon, only about 70% of the

cash contributed by those investors actually was invested in BLMIS, with 30% or more of that cash ultimately being returned to the investors in the form of non-Madoff distributions in 2010 and 2013. In contrast, *all* of the cash contributed by AIJED and Associates to Beacon was invested in BLMIS, and *all* of that investment was wiped out when the fraud was discovered.<sup>7</sup> Despite this imbalance, ordinary investors received just as much credit for their contributions to Beacon as did AIJED. If Beacon is not required to revisit and reduce the Net Equity credit it provided ordinary investors based on their limited exposure to Madoff, neither should Beacon be required to revisit and reduce the Net Equity credit it provided to AIJED in 2005.

**B. AIJED's Net Equity should not be "Reallocated" to Associates**

The Challenging Investors apparently intend to ask this Court not only to reduce AIJED's initial investment in Beacon, but also to "reallocate" most of that investment to Associates based on some kind of "ratio" between cash contributions and stated net asset value. As a preliminary matter, Associates has not raised any objection to the allocation of Net Equity between it and AIJED, and the Challenging Investors should not be allowed to do so on Associates' behalf.

In any event, the proposed reallocation is not consistent with the terms of the Order and should be rejected. Beacon is not authorized to employ a ratio or any other methodology to further apportion the Net Equity of its investors among their respective members, partners or affiliates. The Challenging Investors were closely involved in drafting the Order, and were aware at the time that Beacon's investors included many hedge fund complexes, including, but not limited to, AIJED and Associates. Hurley Decl. ¶ 3, Ex. I. If they believed a ratio should be

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<sup>7</sup> In 2004, the year before AIJED was formed, Associates instructed Beacon to place the majority of Associates' Beacon investment in a special "Madoff only" category to ensure that Beacon's non-Madoff investments did not duplicate other investments held by Associates. Gordon Decl. ¶ 21. When AIJED was formed in 2005, 100% of the amounts withdrawn from Associates and reinvested in AIJED came from Associates' Madoff only account. *Id.* ¶ 22. Since AIJED was also a fund of funds, it too instructed Beacon to allocate AIJED's investment solely to Madoff. *Id.* In April 2007, Associates withdrew the portion of its Beacon investment that was not in the Madoff only account. *Id.* ¶ 23. Hence, AIJED's Beacon investment was 100% exposed to Madoff at all times, as was Associates' post-April 2007. *Id.* ¶ 24.

applied to determine how much Net Equity should be apportioned to related hedge funds based on corresponding withdrawals and redemptions, the Challenging Investors should have proposed as much when they negotiated the Order. That way, their proposed methodology could have been considered and vetted by all of the parties and – if adopted – applied equally to all similarly situated investors. If the Challenging Investors are permitted to effectively amend the Order now through this litigation – and they should not be so permitted – AIJED submits that a comprehensive reexamination of Net Equity will be required using the modified standards for *all* of Beacon’s investors, not just AIJED.

### **CONCLUSION**

For the foregoing reasons, AIJED respectfully requests that the Court overrule the Challenging Investors’ objections, declare that AIJED has Net Equity in the amount of [REDACTED] order Beacon to distribute to AIJED the [REDACTED] that Beacon held back pending resolution of this dispute.

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