

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 (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.

**MEMORANDUM OF INVESTOR HOWARD SIEGEL
WITH REGARD TO THE APPROPRIATE METHODOLOGY TO BE USED TO
COMPUTE INVESTOR ALLOCATION PERCENTAGES USING THE NET EQUITY
(CASH IN / CASH OUT) METHOD AND WITH REGARD TO DETERMINING THE
APPROPRIATE ALLOCATION PERCENTAGE TO BE USED TO ALLOCATE
TRUSTEE RECOVERIES AFTER ALL INVESTORS HAVE RECEIVED BACK THEIR
ENTIRE CAPITAL INVESTMENT**

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1. Methodology to Compute Investor Allocation Percentages Utilizing the Net Equity (CICO) Method.

The Court at the fairness hearing conducted on October 7, 2014, ruled in favor of using the CICO Method to allocate Madoff recoveries among Beacon investors. Specifically, the Minute Entry states "Court rules that Madoff related funds are to be distributed via the Net Investment Method (taking account also of amounts Beacon and Andover Members received from the class action settlement approved by Judge McMahon)." It appears there is some confusion among the parties at the hearing on October 7th regarding the meaning of "taking account also of amounts . . . received from the class action settlement. . . ." as well as the general methodology to be applied in using the CICO Method.

Starting with the general concept of the CICO Method, it would appear that every time there is a distributable amount available, an investors unrecovered remaining investment in Beacon at that point in time should be compared to the total amount of all eligible investors remaining unrecovered investment in Beacon at that point in time to determine the investor's allocation percentage with regard to that distribution. To apply this general concept to Beacon would require starting with all eligible investors remaining unrecovered investments in Beacon at the time of the Madoff fraud discovery in 2008 and adjusting that amount for each subsequent distribution distributed by Beacon. Thus the amounts distributed in 2010 and 2013 as non-Madoff amounts reduced investors' remaining investment in Beacon. So too did the distribution in 2013 of the management fee piece of the class action settlement that ran through Beacon. What is left after subtracting these prior distributions is an investor's remaining unrecovered investment in Beacon prior to the first distribution of Madoff recoveries from the Trustee and elsewhere. However, the Court has ruled that Beacon must "take into account" funds received by

investors directly from the class action that did not run through Beacon. A question arises as to the proper method to take these funds into account when computing an investors' CICO allocation percentage.

Two other concepts need to be introduced before answering the question. First, there are investors in Beacon who became net winners by virtue of taking out more from their accounts than their remaining investment in Beacon. Second, the Court at the hearing suggested that after all investors have received back their investment in Beacon the CICO allocation percentages should not be used to allocate additional funds received by Beacon, and that perhaps Valuation Method allocation percentages should be used.

The CICO Method allocation percentages with respect to investors recovering their investment in an entity should only be computed using amounts that ran through the capital structure of that entity not outside it. To use class action settlement payments that went directly to investors outside of the capital structure of Beacon as part of the computation of the allocation percentage is not the CICO Method or Net Equity Method as the cash was never "in" before it goes "out" and the funds were never part of the net equity of the entity to which the CICO Method is being applied. It distorts the concept and the computation of the CICO allocation percentage, certainly when compared to how the Valuation allocation percentages were computed to determine allocations of non-Madoff funds. It disadvantages those investors who do better under the CICO Method, and so the Court giveth by its ruling to use the CICO Method, but takes away by mixing apples and oranges in the computation of net equity.

There is a solution however, if it was the Court's intention by requiring the taking into account of the class action settlement payments, that these payments would be used to determine when an investor had recovered all its invested capital, but not in determining how the investors

CICO allocation percentage was computed. Thus, the purity of the CICO Method requiring a cash "in" before a cash "out" would be maintained, and the class action settlement payments would be taken into account in determining when a switch was made to another allocation percentage method for recoveries received by Beacon after all investors have received back their capital investments through the combination of funds that ran through Beacon and the class action settlement payments. Computing CICO allocation percentages as described above and determining when investors have recovered all their capital in combination with the class action payments is a workable solution as shown by pro forma computations done by Beacon's internal accountant.

As investors receive distributions sufficient to recover their remaining investment they would be added to the list of net winners and would not participate in additional distributions until all investors had recovered their entire Beacon investment. Those investors still remaining with unrecovered investment would be compared to the total unrecovered investment of the remaining investors to compute a new allocation percentage for the next round of distributions. This process would continue until all investors had recovered their entire Beacon investment. After distribution of the \$51 million currently available, it would take an additional distribution of approximately \$19 million to accomplish the recovery of all Beacon investors unrecovered capital investment.

2. Should Beacon switch to another method of allocation after all investors have recovered their invested capital and if so what method is appropriate.

The Court suggested at the hearing that after all investors have recovered their capital investments that a return to using the Valuation Method allocation percentages for any additional distributions would be appropriate. I disagree with this conclusion.

Valuation method allocation percentages were determined by comparing the amount of an investor's capital account to the amounts in all investors capital accounts. They were last computed prior to the discovery of the Madoff fraud and remain essentially unchanged. The Valuation Method allocation percentages are tainted by the inclusion of Madoff fictitious income in investors' capital accounts. Those investors with larger amounts of fictitious income credited to their accounts get larger shares of distributions utilizing this allocation method. The reason some investors have larger amounts of fictitious income in their capital accounts arises from several factors including the length of time they were investors and contributions and withdrawal patterns over their period of investment. The Court's prior opinion in 2010 sustained the use of the Valuation Method allocation percentages to distribute the non-Madoff funds received from the liquidation of Beacon's legitimate non-Madoff investments. The Court cited Beacon's Operating Agreement and Offering Memorandum as requiring the use of the Valuation Method to allocate the distribution of the non-Madoff funds, but the real foundation for the Court's opinion rested on the fact that the Valuation Method had been consistently used over a period of time and the allocation of these funds using the Valuation Method had previously been credited to investors' capital accounts, determined by the Managing Member, and recorded in Beacon's financial statements.

In my prior Memorandum in this matter at pages 10-14, I discussed the fact that the Operating Agreement does not contain any provision for determining allocation percentages and the Offering Memorandum only provides that an allocation method computed using Members'

capital accounts "generally" applies leaving room within Beacon's governing documents for the Court to choose the allocation method most applicable to a particular situation.

While it is true that once Beacon's investors have recovered their entire invested capital, the rationale for using the CICO allocation method to recover investors' capital is no longer applicable, it is a big leap to return to using tainted Members' capital accounts. There is absolutely no connection between funds being received by Beacon from the Madoff Trustee, after investors have recovered their invested capital, and based on Beacon's CICO investment in Madoff, and the Valuation Method. The Valuation Method allocation percentages were last computed six years ago. They are a vestigial organ of a defunct hedge fund, and have no relevance whatsoever to the allocation of funds obtained by Beacon based upon its unique hard fought agreement with the Trustee to exclude the class action settlement amounts from the amount of its CICO claim against the Madoff Bankruptcy Estate.

It makes much greater sense to go back to investors' remaining capital investment at the discovery of the fraud than to go back and use Members' capital accounts. Investors' capital investment at the time the fraud was discovered at least comports with economic reality and provides a fair comparison of an investor's rights to receive an allocable share of Trustee distributions based on Beacon's capital investment in Madoff. An allocation percentage thus computed is not based on the rationale of recovering unrecovered capital investments, all capital investments having been already recovered, but on the use of real numbers untainted by the inclusion of fictitious income. In the Court's search for an appropriate method to allocate Trustee distributions after all investors have recovered their invested capital, it is much more reasonable to use an economic comparison of real dollar investments than fictitious capital accounts with no relationship to distributions based on Beacon's capital investment in Madoff. To use investor's

ancient capital accounts would allow the crook to pick the winners and losers within the Beacon fund and all courts that have reviewed this issue have said that that should not happen. Those that claimed that the use of CICO method disadvantaged them based on a use of money concept for the length of their investment, were compensated under that theory as part of the class action settlement.

Even after all investors have recovered their capital investments, the 213 investors who received lower allocation percentages under the Valuation percentage should not be required to subsidize those investors, who because of greater amounts of fictitious income in their capital accounts, would receive a larger share of a distribution based on Beacon's Madoff capital investment. It still mixes apples and oranges and the Court should not endorse it.

To summarize, I believe that an order should be issued that provides, that in computing the allocation of distributions under the CICO Method, that the "taking into account" of the class action settlement payments, should be limited to using the amounts so received to determine when an investor has recovered its entire capital investment, and not to be used in the computation of an investor's allocation percentage, which should be determined solely based on recoveries of investor capital that passed through Beacon.

Further the order should provide that allocation percentages computed after all investors have recovered their capital investment should be based on investors' remaining capital investments at the time the Madoff fraud was discovered.

If the Court decides to issue an order to go back to the Valuation Method allocation percentages for post capital investment recovery distributions, it should issue a full opinion setting forth its rationale for doing so.

The above Memorandum is respectfully submitted,

By: /s/ Howard Siegel
Howard Siegel