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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**

**DECLARATION OF  
MAX FOLKENFLIK**

I, Max Folkenflik, hereby declare:

1. I am a member in good standing of the Bar of New York and of this Court, and a Partner at the law firm of Folkenflik & McGerity LLP, formerly Folkenflik & McGerity, counsel for the Fastenberg Intervenors.

2. This Action was brought by the Beacon Funds to obtain a declaratory judgment as to whether distribution of money currently held by those funds should be made by the Valuation Method or the Net Investment Method—sometimes called the Net Equity Method or

the cash in/cash out method. The Valuation Method is essentially the investor's capital account calculated by adding deposits and reported profits (including Madoff fictitious profits) and deducting withdrawals and reported losses. While the Madoff thefts were "written down" in December 2008, for reasons discussed below, that had no effect at all on the relative percentages of Net Asset Value of each of the investors. The Net Investment Method looks only at deposits and withdrawals of cash.

3. This is not the first time Defendant David Fastenberg<sup>1</sup> ("Fastenberg") has appeared before this Court seeking to compel distribution to investors, including him, of funds currently held by the Plaintiff Beacon Funds<sup>2</sup>. The Fastenberg Intervenors filed a motion in the United States District Court for the Southern District of New York seeking a mandatory injunction compelling Beacon Associates Management to distribute the Beacon Funds' then remaining assets (comprised entirely of profits and return of capital from non-Madoff investments) "proportionately in accordance with the capital accounts of the investors less a write-down for the Madoff theft losses on the date of the discovery of those losses." *Beacon Associates Management Corp. v. Beacon Associates LLC I*, 725 F.Supp.2d 451, 452 (S.D.N.Y. 2010). That is, essentially, the Valuation Method.

4. This time, however, Fastenberg seeks an order requiring that the funds recovered by the Beacon Funds from the Madoff bankruptcy proceedings be distributed by the Net Investment Method, and not by the Valuation Method. Fastenberg seeks this different approach for the Madoff recoveries, because the use of the Valuation Method would

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<sup>1</sup>Defendant David Fastenberg, appears as Trustee of the Long Island Vitreo-Retinal Consultants 401k FBO David Fastenberg. While not formally parties to the action, as they were the last time, Fastenberg's counsel also represent approximately 170 other investors in the Plaintiff Beacon Funds.

<sup>2</sup>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".

perpetuate and extend Madoff's frauds and require that later investors lose money so as to subsidize payment of "fictitious profits" to earlier investors such as the Income Plus Investment Fund.

5. Beacon Associates LLC I ("Beacon I") is a limited liability corporation formed in 1995 for the purpose of investing the funds of its members in other investment funds chosen by Beacon I in its discretion. The other Beacon Funds are also limited liability corporations. Since the inception of Beacon I through December 2008, Beacon I invested a substantial portion of its assets under management with Bernard L. Madoff Investment Securities LLC ("BLMIS"), 70% to 75% for the Beacon funds, and the reverse, 25% to 30% respectively, for the Andover funds.

6. Beacon I's Operating Agreement (annexed hereto as Exhibit B) provided that Beacon Associates Management ("Management") should calculate what it referred to as the "Sharing Ratios," that is, the proportionate share of the Beacon Funds' net asset value ("NAV") attributable to each member, by starting with the investor's initial capital contribution, adding any profits earned and subtracting any losses incurred from Beacon's investment activities, and then adding any new contributions made by that investor and subtracting any withdrawals. The Operating Agreements of the other Beacon Funds contained parallel provisions.

7. Throughout the period of the investments by the Beacon Funds in BLMIS, BLMIS reported fictitious "profits" in each and every year, which were credited to the net asset value of Beacon Funds. Since the inception of the Beacon Funds through December 2008, therefore, member's capital accounts, their individual NAV, included fictitious "profits" reported to be earned by BLMIS.

8. On December 11, 2008, Madoff was arrested and confessed to running the largest Ponzi scheme in history. An action was commenced in the United States District Court for the Southern District of New York to appoint a trustee to supervise the collection and liquidation of assets of BLMIS. Thereafter, on December 15, 2008, an application for a protective decree pursuant to 15 U.S.C. § 78eee(a)(3) of the Securities Investor Protection Act (“SIPA”) was filed in the United States Bankruptcy Court for the Southern District of New York (the “SIPC Bankruptcy”) seeking liquidation of BLMIS. Irving H. Picard was appointed as Trustee in the SIPC Bankruptcy.

9. As a result, the Beacon Funds determined to write down to zero the full extent of its then-existing investments in BLMIS. The effect of that write-down was to reduce the capital accounts of the Beacon Funds, and correspondingly the capital accounts of each of the members of the Beacon Funds by approximately 75%. Notably, this “write-down” did not involve any adjustment of individual NAV to correct the distortions resulting from the impact of crediting Madoff fictitious profits over time. An investor with a 1% “sharing ratio” in one of the Beacon Funds before the write-down, continued to have a 1% interest in that fund I after the write-downs. The share of the pie was the same, but the pie had become (or actually had been recognized as being) much smaller than before.

10. On December 18, 2008, Beacon Management determined to liquidate Beacon I. Because approximately 25% of the balance of assets remaining in the Beacon Funds were invested with other managers, some of whom had restrictions on the timing of withdrawals of funds from their control, the liquidation was expected to take a number of months. The Beacon Funds informed their members that they would distribute funds remaining in the Beacon Funds to all investors on or about July 15, 2009.

11. Initially, the Beacon Funds made computations of the remaining assets in the Fund, and the amount that members could expect in liquidation. Those computations were done consistently with the historical practice of the Beacon Funds in computing the NAV of the Fund and the capital account of each member. The write-down for the BLMIS losses was made as of the date that those thefts were discovered.

12. Sometime prior to the end of May 2009, Beacon Management sought an opinion from Roberts & Holland concerning the proper method of computing the distribution of the Beacon Funds' then remaining assets among its members. By letter dated May 27, 2009, Roberts & Holland issued its opinion. Roberts & Holland did a detailed analysis of Beacon's Amended and Restated Operating Agreement dated as of April 1, 2004, which contains the usual method to be followed for the computation of investor capital accounts and each investor's share of the Beacon Funds' profits and losses.

13. Thereafter, the Beacon Funds issued their 2008 financial statements. Beacon's accountants, Citrin Cooperman & Company LLP ("Citrin Cooperman") issued an unqualified opinion on those financial statements. Note 5 to the 2008 financial statements states that the losses on assets held with BLMIS were recorded effective as of December 2008. The note states that "as the company is unable to determine when the loss actually was incurred, the amount of the loss attributable to previous reporting periods cannot be quantified." The Account's opinions on Beacon Funds pre-2008 financial statements, the basis for the capital account computation made by the Beacon Funds, were withdrawn and can no longer be relied upon.

14. In each of the years prior to 2008, dating back to the inception of the Beacon Funds in 1995, members of the Beacon Funds received forms K-1 which included fictional

investment income reported by BLMIS as part of its Ponzi scheme. As a result, each member's Net Asset Values were inflated by the fictitious "profits" reported on the Beacon Funds' BLMIS investments.

15. The Roberts & Holland opinion had noted that Roberts & Holland had been informed by Citrin Cooperman that there was a possibility that other accountants might conclude that the Beacon Funds' financial statements for prior years should be restated to eliminate BLMIS income and to report BLMIS losses *when they occurred*, rather than *when they were discovered*. As a result, Beacon Management declined to distribute the assets of Beacon I on that basis of accounting to its members until it received a ruling from a court declaring that the Valuation Method was the proper method to be used.

16. As a result of the dispute that arose over the proper methodology to follow in valuing the capital balances attributable to individual Beacon Fund investors for purposes of distribution of the non-Madoff invested funds, the Fastenberg Intervenors, recognizing that none of the alternatives proposed by Management was perfect, but speed and pragmatism strongly favored using the Valuation method, filed a motion in the United States District Court for the Southern District of New York seeking a mandatory injunction compelling Management to distribute the Beacon Funds' remaining assets "proportionately in accordance with the capital accounts of the investors less a write-down for the Madoff theft losses on the date of the discovery of those losses." *Beacon Associates Management Corp. v. Beacon Associates LLC I*, 725 F.Supp.2d 451, 452 (S.D.N.Y. 2010) ("*Beacon I*"). The Fastenberg Intervenors argued that any of the other proposed restatement alternatives were deeply flawed, perhaps ultimately un-provable, and invited years of contention and delay. The Fastenberg Intervenors argued that these investors, who had undeniably earned a share of

the Non-Madoff funds, were entitled to get whatever money back they could as quickly as possible.

17. After the initial papers were filed by the parties to the action, the Court provided an opportunity for all the Beacon Funds' investors to file papers in connection with the motion. The Fastenberg Intervenors' motion was opposed by a Beacon member, who wished the distribution to occur not on the basis of the Valuation Method, but the Net Investment Method, on the grounds that the former recognized "fictitious gains" and gave "credence" to fictional profits.

18. The Court concluded, for several reasons, that with respect to the assets then remaining in the Beacon Funds, which were comprised exclusively of Non-Madoff profits and return of Non-Madoff capital, the Valuation Method should be used. *Id.* at 460. The Court noted that the Operating Agreement called for application of the Valuation method, but that fact was not determinative in reaching the Court's conclusion. The Court found it very significant that the Beacon Funds' counsel surveyed all of the Beacon Funds' members and, overwhelmingly, the Valuation Method was the method the majority of members wished to see used in making the distributions. *Beacon*, 725 F.Supp.2d 451, 463.

19. The Court recognized the long line of authority which applied the Net Investment Method, rather than relying on the values reflected in monthly account statements in cases involving Ponzi schemes, but the Court reasoned that the cases employing the Net Investment Method of distribution simply did not apply to the case because the Beacon Funds were "not a Ponzi scheme." Furthermore, the Court reasoned that application of the "Net Investment Method would strip investors of legitimate gains from Beacon's significant non-Madoff investments." *Id.* at 464. Accordingly, the Court granted the Fastenberg Intervenors'

motion to distribute the Beacon Funds' non-Madoff invested funds in accordance with the Valuation Method.

20. Following the decision and order in *Beacon I*, approximately \$133 million was distributed to Beacon Fund investors using the Valuation Method. As a result, those long term investors who had their NAV artificially inflated by fictitious Madoff profits, shared in that distribution as if those fictitious profits had been real.

21. Thereafter, the SIPC Trustee asserted a claim against the Beacon Funds for all withdrawals they had made from BLMIS from inception, in an amount exceeding \$28 million, without regard for the fact that additional investments almost equaled the amount of withdrawals, or the fact that the Beacon Funds' aggregate investments substantially exceeded the amount withdrawn (the "Trustee's Claw-Back Action").

22. As the Court is undoubtedly aware, the Trustee has been very successful in collecting assets for the BLMIS Estate, and significant distributions have been made to BLMIS investors. However, during the pendency of the Trustee's Claw-Back Action, the Trustee refused to make any distributions to the Beacon Funds.

23. Numerous class actions, individual actions and suits by the Department of Labor (the "DOL") and a suit under the Martin Act by the New York Attorney General (the "AG") had been filed against the Beacon Funds, or against its managers and others, including in particular Ivy Asset Management Inc., which had been purchased by the Bank of New York. ("BONY") (collectively the "*Beacon Actions*").

24. The *Beacon Actions* and the *Trustee's Claw-Back Action* were submitted to mediation before David Geronemus, Esq. of JAMS commencing in November, 2011, and ultimately all of those actions were settled. I personally participated in those mediations.

Notably, none of the money recovered in the settlement of the *Beacon Actions* was paid to the Beacon Funds. At the insistence of the DOL and the AG those recovered funds were paid directly to the Beacon Funds investors. Also notably, the DOL and the AG insisted that the distribution amounts be calculated using the Net Investment Method, and not using the Valuation Method. The distributions took into account all amounts paid out from the Beacon Funds, including in particular the amounts distributed pursuant to this Court's order in 2010.

25. Because the settlements included settlement of class actions pursuant to Rule 23, the settlement and plan of distribution required court approval. By order dated May 9, 2013, Judge Colleen McMahon of the United State District Court for the Southern District of New York approved the settlement and plan of distribution. Annexed hereto as Exhibit C is a copy of the decision in *In re Beacon Associates Litigation*, No. 09 Civ 777, 2013 WL 2450960 (S.D.N.Y. May 9, 2013).

26. As a result of the settlement of the Claw-Back Action, the Trustee allowed a claim by the Beacon Funds of in excess of \$159,867,924.62 for the Beacon funds and \$5,032,817.38 for the Andover funds, and released and distributed the Beacon Funds' pro rata share of portions of the amounts recovered by the Trustee for the BLMIS Estate. The Trustee is computing the pro rata share of each investor's recovery, including the recovery by the Beacon Funds, using the Net Investment Method.

27. Currently, the Beacon Funds have received tens of millions of dollars from the Trustee, but there is no agreement on how the distribution of those amounts by the Beacon Funds will be calculated for individual investors.

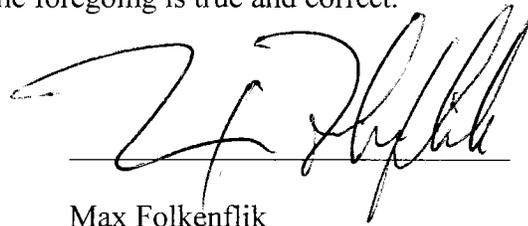
28. On April 2, 2014, counsel for the Beacon Funds commenced an action in the United States District Court for the Southern District of New York, *Beacon Associates LLC I*

*v. Beacon Associates Management Corp.*, No. 14 cv 2294, by filing a Complaint for Declaratory Judgment (the “Complaint”), a copy of which is annexed hereto as Exhibit A. In their complaint, counsel for the Beacon Funds explains the two available methods of distribution – Net Equity and Valuation. (*See* Exhibit A, ¶¶ 40, 41).

29. Plaintiff Fastenberg seeks an order compelling distribution of funds. This time, Plaintiff Fastenberg seeks distribution by the Net Investment Method, the same method that has been used by the Trustee, the same method as was insisted upon by the DOL and the AG, the same method as has been used in every Madoff case dealing with distribution of BLMIS Estate assets. 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,  
August 27, 2014.

A handwritten signature in black ink, appearing to read 'Max Folkenflik', written over a horizontal line.

Max Folkenflik