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.-

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 OF DEFENDANT INCOME-PLUS INVESTMENT FUND IN RESPONSE TO PLAINTIFFS' REQUEST FOR DECLARATORY JUDGMENT

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PRELIMINARY STATEMENT

At issue is whether the Court should order the distribution of funds held by (or due to) Beacon Associates LLC I and Beacon Associates LLC II (collectively, "Beacon" or the "Fund") in a manner consistent not only with the Fund's governing agreements, but also with this Court's July 27, 2010 Order (the "Initial Decision") relating to the distribution of Beacon's assets. Defendant Income-Plus Investment Fund ("Income-Plus") – a Beacon investor[1] – submits this Memorandum to show why the Court's Initial Decision ordering the distribution of Beacon's assets under the Valuation Method (as defined below) is every bit as applicable to the current dispute based on principles of collateral estoppel and contract law. Further, although an equitable analysis comparing the valuation methodology to the alternative net equity methodology proposed by certain other investors is unnecessary given the legal nature of the contractual dispute at issue here, the equities do not favor use of the net equity methodology advanced by certain other investors.

The background facts are well known to the Court and the parties. Although the percentages varied over time, Beacon invested a considerable portion of its assets with Bernard L. Madoff Investment Securities LLC ("Madoff" or "BLMIS"). As a result, Beacon and its investors were among the many victims of Madoff's far-reaching and well-documented Ponzi scheme.

Within weeks of Madoff's December 11, 2008, disclosure of his fraud, Beacon's management notified investors that it would liquidate the Fund. Beacon's management

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[1] Income-Plus invested in Beacon Associates LLC I but, as this Court found in the Initial Decision, the Operating Agreements for the two entities are "virtually identical." *Beacon Assocs. Mgmt. Corp. v. Beacon Assocs. LLC I*, 725 F. Supp. 2d 451, 452 n.1 (S.D.N.Y. 2010) ("*Beacon Assocs. I*"). Income-Plus was not an investor in any of the Andover funds identified in the Complaint. (Compl. ¶ 4.)

eventually sought a declaratory judgment with respect to the appropriate valuation methodology for the distribution of the Fund's remaining assets. That action resulted in this Court's determination that the Valuation Method was the appropriate mechanism for the distribution of Beacon's remaining assets. *Beacon Assocs. I*, 725 F. Supp. 2d 451.

The current proceeding again asks the Court to determine the appropriate methodology for the distribuition of Beacon's assets. To make that determination, the Court must analyze the same facts and legal principles as at issue in *Beacon Assocs. I* – namely, the Fund's governing agreements and the impact of Madoff's fraud on Beacon. Because the issues here are substantially the same as the issues decided in *Beacon Assocs. I*, the doctrine of collateral estoppel bars relitigation of those issues.

Further, even if the Court were to reconsider the issue, the Court's reasoning in *Beacon Assocs. I*, including its analysis of the express and controlling terms of the relevant agreements, once again mandates the use of the Valuation Method for distribution of Beacon's assets.

Finally, even if the Court were inclined to reopen its Initial Decision and bypass the express contractual terms at issue here in favor of a purely equitable analysis, the Net Equity Method (as defined below and as proposed by certain investors) is neither fair nor reasonable. The proposed method should, therefore, be rejected in favor of the contractually-mandated Valuation Method.

FACTUAL AND PROCEDURAL BACKGROUND

A. The Beacon Funds

The Beacon Funds are New York limited liability companies, which are comprised of numerous entities and individuals holding membership interests in the Funds. The governing documents regarding Beacon are the Fund's Amended and Restated Operating Agreement, dated

April 1, 2004, as modified by a Confidential Offering Memorandum, dated August 9, 2004 (the "Operating Agreement"). (Compl. ¶ 14.) Defendant Beacon Associates Management Corp. is the managing member of the Beacon Funds. (Compl. ¶ 2.)

Because more than 25% of Beacon's membership interests are held by benefit plan investors (including ERISA Plans, Individual Retirement Accounts, and non-ERISA Plans), the Funds are subject to the ERISA Plan Asset Rule, 29 U.S.C. § 1002(42). (Compl. ¶ 5.)

B. Income-Plus and Income-Plus' Investment in Beacon

Income-Plus is a group trust formed on December 15, 1993, for the purpose of pooling investment assets of certain qualified pension plans and entities. (Compl. ¶ 17.) J.P. Jeanneret Associates, Inc. ("JPJA") manages the Fund. (Compl. ¶ 41; Declaration of John P. Jeanneret, Ph.D., dated August 27, 2014 ("Jeanneret Dec.") ¶ 3.) Most of the investors in Income-Plus are Taft-Hartley plans located in Upstate New York governed by ERISA. (Jeanneret Dec. ¶ 3.)

Beginning in January 2000, Income-Plus invested in Beacon Associates LLC I and became a party to its Operating Agreement. (Compl. ¶ 4; Jeanneret Dec. ¶ 4.) Income-Plus invested a total of $18,900,000 in Beacon from January 2000 to December 11, 2008, and withdrew a total of $9,000,000, representing a net investment of $9,900,000 through that date. (Jeanneret Dec. ¶ 11.)

C. Beacon's Investment With Madoff

As detailed in the Complaint, from its inception in 1995, Beacon invested a significant portion of its assets with BLMIS. (Compl. ¶ 23.) The percentage of Beacon's assets invested with BLMIS over the years varied – ranging from as low as approximately 70% to as high as approximately 100%. (Compl. ¶ 23; Jeanneret Dec. ¶ 7.)

On December 11, 2008, the world learned that Madoff had been operating a massive Ponzi scheme. (Compl. ¶ 26.) Soon after that, the United States Bankruptcy Court for the Southern District of New York appointed Irving H. Picard as the trustee charged with liquidating BLMIS (the "Madoff Trustee"). The Madoff Trustee's investigation revealed BLMIS had apparently neither purchased nor sold any securities since 1996, but had instead stolen the money from investors (including Beacon) – creating fictional monthly statements that often reflected fictional gains. (Compl. ¶¶ 27-28.)

After disclosure of Madoff's fraud, Beacon's management wrote Beacon's BLMIS investment down to zero (Compl. ¶ 6) and informed Beacon's membership that the Fund would be liquidated (Compl. ¶ 30). On or about April 3, 2009, Beacon filed a proof of claim with the Madoff Trustee ("Proof of Claim") based on the Fund's net loss of $138,324,742. (Jeanneret Dec. ¶ 10.)

D. The Initial Distribution of Beacon's Assets

To determine how to properly distribute Beacon's remaining assets after discovery of Madoff's fraud, Beacon's management consulted the Fund's accountants, who advised of several potential "valuation methodologies." (Compl. ¶ 32.) One such methodology has been referred to as the "Valuation Method." This method treats Beacon's BLMIS losses as occurring due to "market fluctuations" on discovery of Madoff's fraud and allocates the losses on a *pro-rata* basis to each member.[2] (Compl. ¶ 41.) Beacon's accountants also identified various alternative methodologies keyed to what was referred to as the "Restatement Method," which would treat the Madoff losses as occurring in the same month as each of Beacon's investments in BLMIS.

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[2] Stated differently, if an investor's capital balance represented 1% of the Fund as of December 1, 2008, that investor would be allocated 1% of the losses attributable to Madoff. (Compl. ¶ 41.)

Beacon Assocs. I, 725 F. Supp. 2d at 454. The accountants' report did not identify the net equity method adopted by the Madoff Trustee as a potential methodology to be followed by Beacon. (Whiteley Dec., Ex. 3.)

Beacon also retained separate counsel, Roberts & Holland, to review the potential capital account valuation methodologies. (Compl. ¶ 33.) Roberts & Holland issued a written opinion confirming that the most reasonable reading of Beacon's Operating Agreement provided for treating the Madoff losses as occurring when discovered in December 2008 (the Valuation Method), but that the proper valuation methodology for a distribution could be subject to debate. (Compl. ¶ 33; Whiteley Dec., Ex. 4..)

Another proposed methodology, advanced here by certain other Beacon investors, is what has been referred to as the "Net Equity Method," the "Net Investment Method," or the "Cash-in/Cash-out Method" (the "Net Equity Method"). This method, at its most basic level, determines each investor's interest in Beacon by calculating how much each investor contributed to Beacon, and then subtracting from that figure the amount withdrawn by or returned to the investor. (Compl. ¶ 40.)

Unable to find certainty on the method for its initial, post-fraud distribution, Beacon sought a judicial resolution. (Compl. ¶ 34.) On July 27, 2010, this Court ordered the distribution of Beacon's remaining assets pursuant to the Valuation Method proscribed by the Operating Agreement. (Compl. ¶ 35.) In reaching its decision, the Court considered arguments regarding the disbursement of Beacon's assets pursuant to the Valuation Method and other methodologies, including the Net Equity Method. *See Beacon Assocs. I*, 725 F. Supp. 2d at 458-460.[3]

[3] The Net Equity Method had not been advanced by Beacon or its accountants, but was instead proposed by a different Beacon investor, the Estate of P. Neill Petronella. *Beacon Assocs. I*, 725 F. Supp. 2d at 459.

After a thorough analysis of the Beacon Operating Agreement, as well as the arguments in support of the same two methods at issue here – the Valuation Method and the Net Equity Method – the Court held that "Beacon is governed by its Operating Agreement which *requires* that *Beacon's assets* be distributed in accordance with the Valuation Method." *Id.* at 464 (emphasis added). Significantly, the Court did not restrict its Initial Decision to apply to only certain assets of Beacon (such as the "Non-Madoff Assets" – a phrase that does not appear in the Court's opinion), nor did the Court imply that its Initial Decision was limited to liquid assets in the Beacon Funds at that time. *Id.* at 469. In fact, more than a year *before* the Court's Initial Decision – and several months *before* the filing of the Complaint leading to that decision – Beacon filed the Proof of Claim with the Madoff Trustee identifying a net loss of over $138,304,742. (Jeanneret Dec. ¶ 3 & Ex. 1 at p. 13.)[4]

E. The Beacon Assets Identified By Beacon As At Issue In This Proceeding

Since the Court's July 2010 Initial Decision, Beacon's Proof of Claim with the Madoff Trustee has been approved in the amount of $159,867,924.62, Beacon paid to the Madoff Trustee $19,766,425.29 to settle a clawback claim, and Beacon has identified additional funds to be paid to Beacon as the result of the settlement of two derivative actions in Nassau County, New York. (Compl. ¶ 9.) As a result, JPJA believes Beacon now has approximately $75 million currently available in liquid assets available for distribution to its investors and anticipates the receipt of

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[4] The Court, in its Initial Decision, also referenced the fact that Beacon had surveyed its investors to determine whether they favored the Valuation Method or some other method and that a majority of the investors, whether measured individually or weighted based on dollars invested, favored the Valuation Method. *Beacon Assocs. I*, 725 F. Supp. 2d at 458. Here, based on data provided by Beacon, JPJA has determined that 54% of Beacon's investors, on a dollar-weighted basis, would benefit from application of the Valuation Method. (Jeanneret Dec. ¶ 19.)

further payments from the Trustee and other sources for ultimate distribution to the Fund's investors. (Compl. ¶ 38; Jeanneret Dec. ¶ 17.)

Despite the fact the Court ruled on the proper method of valuation for distribution of Beacon's assets in 2010, certain investors represented by Defendants David Fastenberg, Trustee, and Long Island Vitreo-Retinal Consultants 401k FBO David Fastenberg (the "Fastenberg Defendants") advocate for use of the Net Equity Method, arguing generally that the Valuation Method is an incorrect method for distribution of the assets recovered due to the Madoff fraud. (Compl. ¶¶ 18, 43-44.) The Fastenberg Defendants' current position is in direct contravention to their position in *Beacon Assocs. I*.[5] As a result of the dispute among Beacon's investors, just as it did in 2010, Beacon commenced the instant proceeding for a declaratory judgment on the proper methodology for distribution of the moneys received by the Fund related in any way to Madoff's fraud.[6] (Compl. ¶ 45.)

Contrary to the arguments raised by the Fastenberg Defendants, the Valuation Method is the proper methodology for the distribution of Beacon's remaining assets (including assets recovered from the Madoff Trustee) for several reasons. First, this Court's prior decision in *Beacon Assocs. I* definitively resolved the issue. Second, the unambiguous language of the Beacon Operating Agreement requires the use of the Valuation Method under general principles of both contract and ERISA law. Finally, a distribution pursuant to the Net Equity Method as defined in the Complaint is unworkable and unfair as set forth in detail below.

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[5] Indeed, in *Beacon Assocs. I*, the Fastenberg Defendants argued that "Beacon's Operating Agreement 'require[d] distribution based upon the Valuation Method.'" *Id*. at 458 (alteration in original).

[6] This Court has jurisdiction under 28 U.S.C. §§ 1331 and 1367 because the action arises, in part, under the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §§ 1101 *et seq.*, and the relief sought "will materially impact the value of the assets of multiple plans subject to ERISA, and will impact the rights of those ERISA plans." (Compl. ¶ 19.)

ARGUMENT

POINT I

THE DOCTRINE OF *COLLATERAL ESTOPPEL* BARS RE-LITIGATION OF THE COURT'S DECISION ON THE PROPER METHOD FOR DISTRIBUTION OF BEACON'S ASSETS

On August 5, 2009, Beacon's management filed an action "seeking a declaration that it may distribute 'a significant portion of Beacon's remaining assets'" pursuant to the Valuation Method. *Beacon Assocs. I*, 725 F. Supp. 2d at 456-457. As of the filing of that action (the "Prior Action"), Beacon had submitted the Proof of Claim to the Madoff Trustee. (Jeanneret Dec. ¶ 10.)

The Fastenberg Defendants intervened in the Prior Action, seeking a mandatory injunction compelling Beacon to distribute the Fund's remaining assets pursuant to the Valuation Method provided in Beacon's Operating Agreement. *Id.* at 452, 457-458. Other investors submitted arguments in support of the Net Equity Method, while Beacon's management took no position on the methodology. *Id.* at 458-460. In concluding that the Valuation Method was appropriate for the disbursement of Beacon's remaining assets, the Court relied principally on the express terms of Beacon's Operating Agreement governing liquidation – terms the Court concluded were binding on Beacon and its members – and rejected, for two principal reasons, the argument that a net equity methodology used with respect to the liquidation of BLMIS would be applicable to Beacon.

First, "unlike BLMIS, where every dollar invested was subject to Madoff's fraud, Beacon invested approximately thirty percent of its assets with legitimate managers who consistently made profits." *Id.* at 464. As a result, "application of the Net Investment Method would strip

investors of legitimate gains from Beacon's significant non-Madoff investments." *Id.*[7] Second, and most important from the Court's perspective, the ongoing BLMIS liquidation is subject to the Securities Investor Protection Act ("SIPA") which mandates that "customers share *pro rata* in customer property to the extent of their *net equities*, as defined in SIPA," while "Beacon is governed by its Operating Agreement which requires that Beacon's assets be distributed in accordance with the Valuation Method." *Id.*

Collateral estoppel bars re-litigation of this Court's determination in the Prior Action that the Valuation Method is the only appropriate methodology to follow in liquidating the Fund's remaining assets. "For collateral estoppel to bar a party from litigating an issue in a second proceeding, '(1) the issues in both proceedings must be identical, (2) the issue in the prior proceeding must have been actually litigated and actually decided, (3) there must have been a full and fair opportunity for litigation in the prior proceeding, and (4) the issue previously litigated must have been necessary to support a valid and final judgment on the merits.'" *Amadasu v. Bronx Leb. Hosp. Ctr.*, 03 Civ. 6450 (LAK) (AJP), 2005 U.S. Dist. LEXIS 774, at *22 (Jan. 21, 2005) (citations and quotations omitted).

The collateral estoppel doctrine applies with equal force to decisions reached in prior declaratory judgment actions. *See Umhey v. County of Orange, N.Y.*, 957 F. Supp. 525, 529 (S.D.N.Y. 1997) ("collateral estoppel does apply to prior declaratory judgments . . . . Thus, a losing plaintiff cannot hope to relitigate liability by simply requesting different relief in federal court.") (citing *Giakoumelos v. Coughlin*, 88 F.3d 56, 58 (2d Cir. 1996)); Restatement (Second) of Judgments § 33 cmt. b (1995) ("If a declaratory judgment is valid and final, it is conclusive,

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[7] As noted above, the Net Equity Method has also been referred to as the Net Investment Method.

with respect to the matters declared, as to all person who are bound by the judgment.") (additional citations omitted)). Consequently, through "offensive collateral estoppel," a litigant who was not a party to a prior judgment may use a prior judgment "offensively" in order to prevent re-litigation of issues resolved in the earlier proceeding. *See Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 (1979); *see also Bush v. O.P.E.I.U. Local 153*, 499 F. Supp. 2d 571, 573 (S.D.N.Y. 2007) ("The doctrine of collateral estoppel may be invoked by one who is not a party to the original action. The only requirement is that the party against whom the doctrine is applied must have had the opportunity to litigate the merits of the issue in the prior action.")

All four factors supporting collateral estoppel are present here. To begin, *Beacon Assocs. I* involved the identical issue as that presented in this proceeding – the proper methodology to follow for the distribution of Beacon's assets in liquidation. "'[T]he issue identity prong is satisfied if the pleadings, parties and claims reveal significant similarities' between the issues litigated in the prior action and the present one." *M.O.C.H.A. Soc'y, Inc. v. City of Buffalo*, 03-CV-580-JTC, 2010 U.S. Dist. LEXIS 46628, at *7 (W.D.N.Y. May 12, 2010) (quoting *Scheiner v. Wallace*, 832 F. Supp. 687, 695 (S.D.N.Y. 1993) (additional citations omitted)). "To meet the identity-of-issues prong of collateral estoppel, it is not necessary that the issues be exactly identical; it is sufficient that 'the issues presented in [the earlier litigation] are substantially the same as those presented by [the later] action.'" *Zherka v. City of New York*, 459 Fed. App'x 10, 13 (2d Cir. 2012) (quoting *ITT Corp. v. United States*, 963 F.2d 561, 564 (2d Cir. 1992).

Here, although some of the named parties are different for procedural reasons, the parties with a substantive interest in a judicial resolution are Beacon's investors – the same parties with that interest in the Prior Action. Substantively, this action asks the Court to examine the same

operative documents regarding Beacon as those at issue in the Prior Action and again asks whether Madoff's fraud justifies a departure from the liquidation methodology set forth in those documents.

It is true that the Complaint identifies assets available for distribution that were not liquid at the time of the Prior Action. (Compl. ¶ 38.) But it is incorrect to argue that the source of those assets (Beacon's Proof of Claim to the Madoff Trustee and litigation relating to Madoff) were not among Beacon's assets on July 27, 2010, when the Court issued its Initial Decision in the Prior Action. In particular, as noted above, Beacon had filed its Proof of Claim with the Madoff Trustee more than a year earlier – in April 2009 – and the losses incurred by Beacon as a result of Madoff's fraud were the subject of several lawsuits. *See, e.g.*, *In re Beacon Assocs. Litigation*, 09-cv-0777 (LBS/AJP).

The second and third factors relevant to a collateral estoppel analysis – actual litigation of the issues and a full and fair opportunity for that litigation – can be discussed together. "[F]or a question to have been actually litigated . . . it must have been properly raised by the pleadings or otherwise placed in issue." *Evans v. Ottimo*, 469 F.3d 278, 282 (2d Cir. 2006); *see also Linden Airport Mgmt. Corp. v. New York City Econ. Dev. Corp.*, No. 08 Civ. 3810 (RJS), 2011 U.S. Dist. LEXIS 60283, at *18 (S.D.N.Y. June 1, 2011). As acknowledged in the current Complaint, Beacon's management brought the prior declaratory judgment action for the express purpose of resolving "a dispute among investors and Management as to the proper valuation methodology." (Compl. ¶ 34.)[8] That issue was then "actually litigated" through a motion filed by the Fastenberg Defendants (then appearing as intervenors) "seeking a mandatory injunction compelling

[8] The dispute was ultimately less between Management and the investors than between the investors, *Beacon Assocs. I*, 725 F. Supp. at 460, as is the case here.

Management to distribute Beacon's 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 Assocs. I*, 725 F. Supp. 2d at 452. The litigation included the Fastenberg Defendants' filing of a complaint in intervention, their motion for a mandatory injunction, the submission of briefs by Beacon and by other investors in Beacon – including an investor (Petronella) advocating the Madoff Trustee's net equity methodology – and a fairness hearing at which the court heard testimony from several investors. *Id.* at 457-458, (*See also* Whiteley Dec., Ex. 1, *Beacon Assocs. Mgmt. Corp. v. Beacon Assocs. LLC I*, Docket No. 1:09-cv-06910-CM, Dkt. 25, 26, 42, 61 & 63.) In sum, there can be no question that the proper methodology for the distribution of Beacon's remaining assets was "actually" litigated in the Prior Action.

The Second Circuit has held that the primary factor in considering whether a party had a "full and fair opportunity to litigate" in a prior proceeding focuses on whether the party "was fully able to raise the same factual or legal issues" in the prior proceeding. *Lafleur v. Whitman*, 300 F.3d 256, 274 (2d Cir. 2002). Further, it is incumbent upon the party opposing the doctrine of collateral estoppel to show that it did not have a full and fair opportunity to litigate the issue. *See Amadasu*, 2005 U.S. Dist. LEXIS 774, at *25 n.10. Here, the full and fair opportunity to litigate the issue is readily apparent from a review of the arguments advanced in the prior proceeding by Beacon and various investors, including, of course, the Fastenberg Defendants, who strenuously advocated in favor of the Valuation Method in that proceeding, arguing that "Beacon's Operating Agreement 'requires that Management make distributions using the Valuation Method'" and that application of other methods would "unsettl[e] a whole series of transactions previously engaged in on the basis of [the] certified financial statements." *Beacon*

Assocs. I, 725 F. Supp. 2d at 458-460; cf. *Neilson v. Straight-Out Promotions, LLC (In re Tyson)*, 511 Fed. App'x 120 (2d Cir. 2013) (no full and fair opportunity to litigate when judgment was entered due to default). The Fastenberg Defendants cannot contend now that they did not have the opportunity to litigate for the Net Equity Method with respect to certain Beacon assets simply because those assets were not liquid at the time, particularly given the fact that the parties must have been aware of the Proof of Claim submitted by Beacon and the potential to receive significant monies from the Madoff Trustee.

Finally, there can be no question this Court "actually decided" the valuation issue and that the issue was "necessary to support a valid and final judgment on the merits." After an analysis of the Beacon Operating Agreement, and the arguments in support of the Valuation Method as well as the Net Equity Method, the Court held that "Beacon is governed by its Operating Agreement which *requires* that Beacon's assets be distributed in accordance with the Valuation Method." *Beacon Assocs. I*, 725 F. Supp. 2d at 464 (emphasis added). Notably, the Court did not confine its Initial Decision to certain assets of Beacon (other than ordering a reserve for litigation and a restraint from distributing moneys to certain parties). *Id.* at 469. Nor did the Court limit its opinion only to those assets in Beacon at that time. *Id.* Thus, by operation of law, the Court's Initial Decision in *Beacon Assocs. I* applies to *all of Beacon's assets subject to liquidation*, and the proceeds paid to date to Beacon by the Madoff Trustee are now assets that Beacon must distribute in accordance with this Court's Initial Decision in the Prior Action.

The same is true for any future amounts to be paid by the Madoff Trustee to Beacon, as well as amounts received in settlement or from any other source. In all instances, under the terms of the Operating Agreement, once funds are deposited into Beacon, those funds are considered the assets of Beacon and governed by the Operating Agreement. *See infra*, p. 14.

POINT II

THE BEACON OPERATING AGREEMENT CLEARLY MANDATES USE OF THE VALUATION METHOD

A. The Unambiguous Language Of The Beacon Operating Agreement Requires use of the Valuation Method

Even in the absence of the collateral estoppel principles discussed above, the documents governing the operation of Beacon require application of the Valuation Method to all of Beacon's assets, irrespective of their source.

Beacon is a New York limited liability company comprised of numerous entities and individuals holding membership interests in the Fund. (Compl. ¶ 14.) To become a member, investors were required to make initial capital contributions of $500,000 or more, although Beacon's management had the discretion to allow for lower thresholds. (Comp. ¶ 22.) Beacon pooled the capital contributions made by investors for the purpose of investing capital in "securities and financial instruments of every kind and description," including equity securities, securities options, convertible securities, and other investment funds. (Compl. ¶ 21; Whiteley Dec., Ex. 2, Operating Agreement art. III, ¶ 1 & art. VIII, ¶ 6.)

Beacon's affairs have at all times been governed by the terms of the Operating Agreement. (Jeanneret Dec. ¶ 6.) Pursuant to the Operating Agreement, members were assigned a "Capital Account" that was "equal to [their] proportionate share of the Net Worth of the Company." On distribution, the Operating Agreement provides that Beacon's remaining assets are to be distributed to "Members in accordance with their positive Capital Account balances . . . ." (Whiteley Dec., Ex. 2, Operating Agreement art. XIV, ¶ 2.1(iii).)

"It is axiomatic that where the language of a contract is unambiguous, the parties' intent is determined within the four corners of the contract, without reference to external evidence." *Bank of N.Y. Mellon Trust Co. v. Solstice ABS CBO II, Ltd.*, 910 F. Supp. 2d 629, 641-642

(S.D.N.Y. 2012) (quoting *Feifer v. Prudential Ins. Co. of Am.*, 306 F.3d 1202, 1210 (2d Cir. 2002); *see also Lockheed Martin Corp. v. Retail Holdings, N.V.*, 639 F.3d 63, 69 (2d Cir. 2011) ("Ambiguity is determined by looking within the four corners of the document, not to outside sources.") (quotations omitted); *Rosenblatt v. Christie, Manson & Woods, Ltd.*, 195 F. App'x 11, 12 (2d Cir. 2006) ("Where, as here, a contract is unambiguous**,** it is enforced according to its terms, and the court will generally not look 'outside the four corners of the document' to add to or vary it."); *Maniolos v. United States*, 741 F. Supp. 2d 555, 566 (S.D.N.Y. 2010) (finding the terms of an offer in compromise unambiguous and enforceable).

"[A] contract is unambiguous if the language it uses has a definite and precise meaning, as to which there is no reasonable basis for a difference of opinion." *Universal Bonding Ins. Co. v. Bay Prop. Assocs.*, 09 Civ. 10030 (FM), 2011 U.S. Dist. LEXIS 117713, at *18 (S.D.N.Y. Oct. 5, 2011) (quoting *Lockheed Martin Corp. v. Retail Holdings. N.V.*, 639 F.3d at 69). "Thus, in such circumstances, 'the court need not look to extrinsic evidence of the parties' intent or to rules of construction to ascertain the contract's meaning.'" *Id.* (quoting *American Home Prods. Corp. v. Liberty Mut. Ins. Co.*, 748 F.2d 760, 765 (2d Cir. 1984)); *see also County of Suffolk v. Alcorn*, 266 F.3d 131, 138 (2d Cir. 2001) ("If a contract is unambiguous on its face, the parties' rights under such a contract should be determined solely by the terms expressed in the instrument itself rather than from extrinsic evidence as to terms that were not expressed or judicial views as to what terms might be preferable."); *In re Residential Capital, LLC*, 497 B.R. 403, 417 (Bankr. S.D.N.Y. 2013) ("Case law commands that an 'unambiguous contract must be enforced according to the plain meaning of its terms.'") (additional citations omitted).

Here, just as the Court found in *Beacon Assocs. I*, Beacon's Operating Agreement – a contract between and among the investors and Beacon – unambiguously sets forth the rights and obligations of the members on liquidation of the Fund. Specifically, as the Court observed:

> Pursuant to Article XIV of Beacon's Operating Agreement, upon dissolution, Beacon's remaining assets are to be distributed to "Members in accordance with their positive Capital Account balances taking into account all Capital Account adjustments for the Company's taxable year in which the dissolution occurs."

Id., 725 F. Supp. 2d at 460.

The Court held in its Initial Decision that this language "clearly mandates that each member's distribution equal their proportionate share of [Beacon's] remaining assets." *Id.* (alterations in original). Nothing has changed in this proceeding. The *same* language in the *same* Operating Agreement is at issue here. And because that language is "complete, clear, and unambiguous," it must be enforced according to its terms, just as the Court did in *Beacon Assocs. I*. *Keiler v. Harlequin Enters.*, 751 F.3d 64, 69 (2d Cir. 2014) (citing *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002)).

B. The Source Of The Funds Received By Beacon Does Not Favor Using Net Equity

The Complaint seeks direction as to the distribution of Beacon's remaining assets and identifies various categories of funds depending on their source, as follows:

> (a) A portion of the Beacon Bankruptcy Recovery of $49,283,342.11 (which is the full $69 million, less the $19,766,425.29 which was clawed back by the Trustee and then paid back to Beacon as party of the Bankruptcy Recovery) ("Net Bankruptcy Recovery");
>
> (b) A portion of the Beacon Bankruptcy Recovery in the amount of $19,766,425.29 which was clawed back by the

Trustee from Non-Madoff Assets and then recovered in the form of the Bankruptcy Recovery ("Clawback Amount");[9]

(c) Future money due to Beacon from the Madoff Trustee based upon an Allowed Madoff Bankruptcy claim of $159,867,924.62 (which if fully paid would include the Clawback Amount);

(d) Beacon settlement funds in the amount of approximately $1,617,330.00, which are proceeds of a settlement of two shareholder derivative actions pending in Nassau County, New York in the amount of $2,450,500.00 less 33% legal fees to shareholder plaintiffs' counsel and less expenses (the "Nassau Settlement"); and

(e) Any future recoveries by Beacon, due to Madoff losses, from any source.

(Compl. ¶ 38.)

There is nothing in the language of the Operating Agreement governing Beacon, however, to allow for a distribution of assets tied to the source of the assets received by Beacon. To the contrary, the Operating Agreement provides that all of Beacon assets be pooled and that members' capital accounts are calculated based on their proportionate share of the Fund's net worth" of the Fund. (Whiteley Dec., Ex. 2, Operating Agreement art. I, ¶ 43 & art. VIII.) Put another way, Beacon's investors did not have an interest in any particular investment of the Fund (such as BLMIS or any other manager) and, therefore, have no contractual right to seek a different distribution methodology based on whether funds have been returned to Beacon by any particular investment manager or, in this case, a trustee responsible for liquidating the assets of a particular manager. *See Beacon Assocs. I*, 725 F. Supp. 2d 466-467. Notably, in its Initial

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[9] Beacon had reserved $20 million with respect to the Trustee's clawback claim in 2010, withdrawing funds for the reserve from investor accounts and segregating the funds into a separate account. (Jeanneret Dec., Ex. 1 at p. 14.)

Decision, this Court rejected an argument that investments should be returned in full to investors who had become members of Beacon after Beacon's last investment with BLMIS.

> It is irrelevant that particular contributions by [the investors] were made after Beacon's last placement with BLMIS, and [their] argument that [their] contribution was "effectively separated from funds which were transferred to the legal possession of Madoff" . . . is misplaced. Once [their] contributions were accepted by Beacon, the money became a Beacon asset and they received an incrementally larger "share of the Net Worth of the Company," including "all cash and cash equivalents . . . , accrued interest and the market value of all securities and other assets of" Beacon . . . . The funds were not segregated in [the investors'] accounts, but were part of Beacon's general assets.

Id. at 467. The Bankruptcy Court overseeing the liquidation of BLMIS provided a similar analysis when rejecting the individualized proofs of claim filed by individual investors in fund-of-funds such as Beacon, finding that the investors never had an interest in BLMIS but, rather, had an interest in the relevant investment fund that had, in turn, invested in Madoff. *In re Sec. Investor Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 454 B.R. 285, 295 (Bankr. S.D.N.Y. 2011) (investors in fund-of-funds did not have property interest in the funds' Madoff investments, but rather "mere ownership interests" in the funds themselves). Because Beacon's investors did not have investments in BLMIS, there is no basis for ordering a distribution based on the methodology followed by the Madoff Trustee, particularly when, as here, the distribution would be inconsistent with the methodology mandated by the Operating Agreement.

C. Applying A Net Equity Methodology Would Require Reforming The Operating Agreement, But There Is No Basis For Reformation

Because Beacon's Operating Agreement is clear and unambiguous – as this Court recognized in its Initial Decision – there is no basis for what would in essence be a reformation of the Agreement in favor of the Net Equity Method. *In re Dynegy Inc.*, 486 B.R. 585, 590 (Bankr. S.D.N.Y. 2013) (when contractual terms are clear and unambiguous, courts should not

rewrite them "under the guise of interpretation," nor should a court redraft a contract to accord with its sense of equity on the facts) (quoting *Cruden v. Bank of N.Y.*, 957 F.2d 961, 976 (2d. Cir 1992) (internal quotation omitted).

Faced with these restrictions, New York courts have sharply limited the remedy of reformation both procedurally and substantively. *Collins v. Harrison-Bode*, 303 F.3d 429, 435 (2d Cir. 2002) (citations omitted).[10] "The proponent of reformation must 'show in no uncertain terms, not only that mistake or fraud exists, but exactly what was really agreed upon between the parties.'" *Id*. at 435 (citations omitted).

Here, the advocates of the Net Equity Method cannot plausibly argue the kind of mutual mistake or fraud at inception that could conceivably justify a court to equitably reform the Operating Agreement. *See CIGNA Corp. v. Amara*, 131 S. Ct. 1866, 1869 (2011) ("[t]he power to reform contracts (as contrasted with the power to enforce contracts as written) is a traditional power of an equity court, not a court of law, and was used to prevent fraud."). In fact, as discussed in detail in the Initial Decision, while the parties did not anticipate the scope of

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[10] This is in part because "[f]ew principles are better settled in the law of contracts than the requirement of definiteness." Restatement (Second) of Contracts § 33 (1981). In fact, "[d]efiniteness as to material matters is of the very essence of contract law, for without it a court could not intervene without imposing its own conception of what the parties should or might have undertaken, rather than confining itself to a bargain to which they have mutually committed themselves." *Pure Power Boot Camp, Inc. v. Warrior Fitness Boot Camp, LLC*, 813 F. Supp. 2d 489, 515 (S.D.N.Y. 2011) (quoting *Bernstein v. Felske*, 143 A.D.2d 863, 864-865 (2d Dep't 1988) (additional citations omitted); *see also W.W.W. Assocs. v. Giancontieri*, 77 N.Y.2d 157, 163 (1990) ("An analysis that begins with consideration of extrinsic evidence of what the parties meant, instead of looking first to what they said and reaching extrinsic evidence only when required to do so because of some identified ambiguity, *unnecessarily denigrates the contract and unsettles the law*") (emphasis added). Thus, "[c]ontract provisions must be interpreted in a manner that gives effect to the parties' reasonable expectations at the time of contract formation." *In re S. Side House, LLC*, 451 B.R. 248, 263 (Bankr. E.D.N.Y. 2011) (citing *Omni Berkshire Corp. v. Wells Fargo Bank*, 307 F. Supp. 2d 534, 539 (S.D.N.Y. 2004)(additional citations omitted)).

Madoff's fraud, the Operating Agreement disclosed that Beacon's Net Asset Values (as defined in the Agreement) would be dependent on the valuations provided by the investment managers, and that Beacon could not provide any assurances as to the accuracy of those valuations. *Beacon Assocs. I*, 725 F. Supp. 2d at 461. Even more pointedly, the Court noted that:

> In a section entitled "Company Risks," the Offering Memorandum is explicit: "Although the Managing Member endeavors to verify the integrity of its Managers and broker it utilizes, there is always the risk that they could mishandle or convert the securities or assets under their control."

Id. In sum, there is no basis for rewriting Beacon's Operating Agreement and applying a methodology for liquidating the Fund's remaining assets that is inconsistent with the parties' contractual rights and obligations, and with this Court's Initial Decision.

POINT III

THE NET EQUITY METHOD AS IDENTIFIED IN THE COMPLAINT IS NOT AN APPROPRIATE ALTERNATIVE TO THE METHOD PROVIDED FOR IN BEACON'S OPERATING AGREEMENT

As summarized in the Complaint, the advocates of the Net Equity Method argue that the Valuation Method incorporates fictitious profits reported by Madoff and should, therefore, be discarded in favor of the Net Equity Method. As discussed above, general principles of contract law and the doctrine of collateral estoppel preclude the use of the Net Equity Method and mandate the use of the Valuation Method agreed to by all investors on their adoption of the Operating Agreement.

But even if the Court were inclined to consider an alternative methodology divorced from the controlling Operating Agreement, the Net Equity Method as identified in the Complaint would be inappropriate for several reasons.

First, although the advocates of the Net Equity Method rely heavily on the fact that the method was used by the Madoff Trustee in determining Beacon's claim against BLMIS, the Net Equity Method identified in the Complaint is *not* the same method followed by the Trustee. In particular, the Trustee, dealing only with money in and money out of BLMIS, was necessarily calculating Net Equity based on money invested with Madoff. That is not the method identified in the Complaint with respect to Beacon. Instead, the Net Equity Method, "for the purpose of the distributions at issue here, has been calculated as the amount of the investor's investment of principal less any withdrawals or distributions received from the Funds, including the distributions made by the Funds in 2010." (Compl. ¶ 40.) Because the distributions in 2010 were of the assets remaining in Beacon after the discovery of Madoff's fraud – and prior to any distributions to Beacon from the Madoff Trustee – those distributions had nothing to do with money in and money out of Madoff. As a result, the methodology followed by the Madoff Trustee in the context of the SIPA liquidation has no bearing on the issue presented here.

Second, the Net Equity Method identified in the Complaint, although purportedly seeking to guard against certain investors benefitting from Madoff's "fictitious" profits, does not accomplish this goal because it ignores Beacon's historical investment history with Madoff. To determine the scope of "fictitious" profits received by investors, any net equity calculation would have to consider percentages of Beacon assets invested with Madoff at the time of each Beacon investor's contribution or withdrawal from the Fund. (Jeanneret Dec. ¶ 21.) The method set forth in the Complaint does not do so.

Third, the Net Equity Method identified in the Complaint makes no provision for the receipt of funds from collateral sources relating to Madoff's fraud. For example, with respect to certain class action litigation discussed in the Complaint, investors received direct payments

from the settlement administrator, but those amounts have not been included in the amounts distributed to Beacon's investors for the purpose of determining the investors' "net equity" in Beacon. According to Beacon's audited 2011 financial statements, the Fund's investors were allocated approximately $100,000,000 from the proceeds of consolidated litigation relating to Beacon's investment in BLMIS. (Jeanneret Dec., Ex. 1 at p. 16.) Those funds were allocated and distributed directly to the investors in Beacon. (*Id.*) The analysis also fails to consider amounts actually received by investors from insurance claims and other potential sources of recovery.

Fourth, because application of the Net Equity Method would be inconsistent with Beacon's Operating Agreement, it also would be inconsistent with those provisions of ERISA requiring plan fiduciaries to act in accordance with plan documents. 29 U.S.C. § 1104(a). In particular, Section 1104(a) requires plan fiduciaries to adhere to the terms of the relevant plan documents and is intended to limit discretion by providing fiduciaries with a clear rule when an issue is expressly governed by the plan documents. *See Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan*, 555 U.S. 285, 288 (2009); *see also Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 83 (1995) (ERISA's statutory scheme "is built around reliance on the face of written plan documents"). Here, there is no dispute that Beacon is subject to ERISA. (Compl. ¶ 5.) As to what constitutes a plan document, Beacon's Operating Agreement meets the definition supplied by the Second Circuit, which has held that plan documents are "the formal legal documents that govern or confine a plan's operations . . . ." *Board of Trustees of CWA/ITU Negotiated Pension Plan v. Weinstein*, 107 F.3d 139, 142 (2d Cir. 1997). JPJA's review of documents provided by Beacon reveals that 51 of Beacon's investors are identified as ERISA funds. (Jeanneret Dec. ¶ 61.) If Beacon were to distribute $75 million received from the Madoff

Trustee under the Net Equity Method, 20 of those funds would receive, in total, approximately $5.6 million less than what the Operating agreement – the governing plan document – entitles them to receive. (*Id.*)

Finally, the Net Equity Method unnecessarily complicates the liquidation, as the Complaint itself reveals by describing the problem presented with respect to expenses, requesting that that the Court also declare an appropriate methodology for the allocation of expenses against "Non-Madoff Funds and recovered Madoff Funds." (Compl., "Wherefore" clause, p. 16.) There will be no need for the Court to enter this particular thicket if the funds received from the Madoff Trustee and any other sources are distributed under the Valuation Method as contemplated by the Operating Agreement.

CONCLUSION

For the reasons set forth in this Memorandum, Defendant Income-Plus Investment Fund respectfully requests that this Court issue an Order mandating that all remaining assets of Beacon, including any assets received to date and in the future from the Madoff Trustee, and also including the proceeds of any litigation settlements relating to Beacon's Madoff-related investments, whether received or to be received in the future, be distributed under the Valuation Method, together with such other and further relief the Court may deem just and proper.

DATED: August 27, 2014

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CERTIFICATE OF SERVICE

I hereby certify that on August 27, 2014, I electronically filed the foregoing Memorandum of Defendant Income-Plus Investment Fund in Response to Plaintiffs' Request for a Declaratory Judgment 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