

**UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

BEACON ASSOCIATES LLC I, BEACON
ASSOCIATES LLC II, ANDOVER
ASSOCIATES LLC I, ANDOVER
ASSOCIATES (q) LLC,

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.,

No. 15-1157

**CIVIL APPEAL PRE-ARGUMENT STATEMENT (FORM C)
ADDENDUM “A”**

This appeal arises out of an action filed by Beacon Associates LLC I and Beacon Associates LLC II (“Beacon”), investment funds that were investors in Bernard L. Madoff Investment Securities LLC (“Madoff”). S.D.N.Y. Case No. 1:14-cv-02294-AJP.¹ Upon the filing of the Complaint in that action, Beacon was in possession of funds received in connection with distributions from the Trustee in the Madoff bankruptcy. S.D.N.Y. Case No. 1:14-cv-02294-AJP, ECF No. 1. Beacon sought a declaratory judgment pursuant to 28 U.S.C. § 2201 with respect to the appropriate method for distributing these funds and funds it expected to receive in the future to its investors. Beacon also sought mandatory enforcement of that judgment pursuant to Fed. R. Civ. Pro. 65.

¹ The parties to the district court action consented to the magistrate judge’s authority to conduct the proceedings below and enter final judgment. Accordingly, the April Order is directly appealable to the Court of Appeals. *See* S.D.N.Y. Case No. 1:14-cv-02294-AJP, ECF NO. 13; Feb. 5, 2015 Tr. at 19-20.

On October 31, 2014, the district court ordered that Beacon distribute all money in accordance with the “Net Equity Method” (the “October Order”).² S.D.N.Y. Case No. 1:14-cv-02294-AJP, ECF No. 51. The October Order signed by Judge Peck was intended to “mirror[] precisely” the net equity approach selected by the trustee in the *Madoff* cases, an approach that was later confirmed and further explained in decisions from the Second Circuit and Southern District of New York. S.D.N.Y. Case No. 1:14-cv-02294-AJP, ECF No. 79 at 11; *SIPC v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff)*, 654 F.3d 229 (2d Cir. 2011); *SIPC v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff)*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010).

Under the Net Equity Method, Beacon must determine each of its investor’s Net Equity by subtracting the investor’s withdrawals from Beacon from the investor’s contributions to Beacon, without giving credit to any investor for “fictitious profits” created by the Madoff fraud. An investor that contributed more to Beacon than he, she or it withdrew has positive Net Equity, and is entitled to a proportional share of further Beacon distributions.

The facts relevant to this appeal are all undisputed. Appellant AIJED International Ltd. (“AIJED”), a Cayman Island “fund of funds” organized in 2005, was an investor in Beacon. AIJED’s first 41 members were persons and entities that, in June 2005, redeemed their investments from a separate fund called AIJED Associates LLC (“Associates”). To pay these redemptions, AIJED withdrew amounts from the funds in which Associates was invested (including Beacon) sufficient to cover the redemptions of the 41 withdrawing investors, who in turn re-invested those amounts in AIJED. Rather than requiring cash redemptions and reinvestments, Beacon booked the transactions collectively as a June 2005 “transfer” from Associates’ Beacon account to AIJED’s separate Beacon account, in the face amount of a portion

² The October Order is not being appealed here.

of the then-stated net asset value of Associates' Beacon investment. The face amount of the transfer was slightly less than the amount of Associates' Net Equity in Beacon at that time. The question presented below was how AIJED's Net Equity should be determined in light of the fact that AIJED received a transfer of funds from Associates' Beacon account in that was in excess of the Net Equity then available to Associates.

This precise issue was presented and determined in a recent decision in the *Madoff* bankruptcy case. *SIPC v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff)*, 522 B.R. 41 (Bankr. S.D.N.Y. 2014), ("*Madoff III*"). In *Madoff III*, Judge Bernstein determined that the "Inter-Account Method" must be applied to determine the amount of Net Equity in an investor's account where the account balance depends in part on a transfer from another investor's account. Under the Inter-Account Method, the trustee determines the amount of Net Equity available in the transferor account at the time of the transfer, and credits the transferee account up to that amount. As Judge Bernstein made clear, however, the transferor and transferee accounts remain separate, with their respective Net Equity balances calculated separately. As explained above, Associates (the "transferor"), had slightly less in Net Equity at the time of the transfer than the face amount of the transfer. Hence, the amount credited to AIJED's account for the 2005 transfer from Associates should have been reduced to the amount of Associates' available Net Equity at that time. AIJED's Net Equity – which, under *Madoff III*, still would be calculated separately from Associates' Net Equity – would be subject to a corresponding reduction, and AIJED would be entitled to a substantial current distribution.

According to Irving Picard, the Inter-Account Method is the "only" method for handling inter-account transfers that is consistent with the Net Equity approach to distribution – the same distribution approach that the district court expressly adopted in this case. Nevertheless, in a two

page double spaced opinion on April 8, 2015 (the “April Order”), the district court declined to apply the Inter-Account Method to determine AIJED’s Net Equity and, indeed, failed even to cite *Madoff III*, even though all parties below acknowledged that the logic of *Madoff III* was dispositive of, or at least plainly relevant to, the dispute below. Instead, the district court held that because AIJED and Associates are in some sense “related,” AIJED’s account should be “combined” with Associates’ account, with a single Net Equity value being calculated for the two separate investors.

The district court’s decision, in other words, is directly at odds with *Madoff III*, which expressly held that the transferee and transferor accounts must remain separate, with their Net Equity calculated separately, even in cases where the owners of the two accounts were related. After AIJED and Associates separated in 2005, Associates made substantial net withdrawals from Beacon, while AIJED made substantial net contributions. When the two accounts are “combined,” however, AIJED’s substantial positive Net Equity is wiped out, denying AIJED the recovery to which it is entitled under Inter-Account Method. In view of the hundreds of Madoff and Beacon investors that are likely situated similarly to AIJED and Associates, AIJED submits that the conflict between *Madoff III* and the district court’s decision below should be promptly resolved by this Court to avoid confusion and the risk of inconsistent outcomes.

AIJED timely noticed this appeal from the April Order on April 14, 2015. The district court’s October Order and April Order are attached to this Addendum as Exhibit A-1 and A-2. The Notice of Appeal is attached to this Addendum as Exhibit A-3. The district court’s docket sheet is attached to this Addendum as Exhibit A-4.