

Max Folkenflik, Esq.
FOLKENFLIK & McGERITY LLP
Attorneys for the Fastenberg Intervenors
1500 Broadway
21st Floor
New York, New York 10036
(212) 757-0400
mfolkenflik@fmlaw.net

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 IN SUPPORT OF
ADJUSTMENTS TO NET
EQUITY**

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 Defendant David Fastenberg.¹ I make this Declaration in support of certain adjustments to the calculation of the net equity of individual investors. Without those adjustments, those investors will be receiving distributions of profits, predominantly fictitious Madoff Profits while other investors have still not received a full return of their cash invested.

2. I have been personally and deeply involved in the various matters concerning the Beacon Funds² since shortly after the discovery of the frauds committed by Bernard Madoff in 2008. This declaration is based on my personal knowledge, and on review of business records and computations produced by the Beacon Funds in discovery, discussions with Beacon Fund personnel and counsel, as well as computations produced by the manager of AIJED International Ltd, a fund invested in the Beacon Funds, and its affiliated fund, AIJED Associates LLC, and conversations with their manager and counsel. I have also had factual discussion with my client, Family Management Corporation, the investment advisor of more than one half, by number, of the investors in the Beacon Funds.

3. Annexed hereto as Exhibit A is a true copy of the transcript of hearing before this court on October 7, 2014.

4. Annexed hereto as Exhibit B is a true copy of the order issued by this court on October 31, 2014.

¹ 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.

² 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".

5. Annexed hereto as Exhibit C is a spreadsheet prepared by the Beacon funds showing the computation of distribution amounts and holdbacks for investors in the Beacon Funds.

6. Annexed hereto as Exhibit D is a spreadsheet prepared by the Beacon funds showing the computation in detail of the holdback for AIJED International LTD, and the effect of treating that account and the account of AIJED Associates LLC (hereinafter "AIJED I")³ as merged with the account of AIJED International LTD (hereinafter "AIJED II," and collectively with AIJED I the "AIJED Funds").

7. Annexed hereto as Exhibit E is a document prepared by the AIJED Funds showing contributions and transfers between AIJED I and AIJED II.

8. Annexed hereto as Exhibit F is a spreadsheet prepared by Beacon Funds showing the allocation of cost basis pro rata based on relative net asset value of AIJED I and AIJED II at the time of the transfer.

9. Annexed hereto as Exhibit G is a spreadsheet prepared by the Beacon Funds showing the holdbacks in computation of an detailed computation regarding the investors in First Frontier LP.

10. Annexed hereto as Exhibit H is a spreadsheet prepared by the Beacon Funds showing the deposits and withdrawals from her Beacon Fund accounts by Karin Stoller

11. Annexed hereto as Exhibit I is a spreadsheet prepared by counsel for Defendant Fastenberg and Karin Stoller showing the allocation of cost basis to Karin Stoller's new account at the Beacon Funds based on the net asset value of the account she closed, and the

³ AIJED I's account at the Beacon Funds was held through a variety names and the account asset investments were treated in different ways at different times, but none of those changes are material to the issues being addressed in this proceeding. Those accounts are all collectively referred to as AIJED I.

time it was closed, and the net asset value of the new account she opened at the time the new account was opened.

THE BEACON FUNDS AND THE MADOFF LOSSES

12. 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 with the same investment purposes.

13. Since the inception of Beacon I through December 2008, the Beacon Funds invested a substantial portion of its assets under management with BLMIS, 70% to 75% for the Beacon funds, and the reverse, 25% to 30% for the Andover Funds. Beacon's Operating Agreement provided that 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, then adding any profits earned and subtracting any losses incurred from Beacon's investment activities, and adding any new contributions made by that investor, and subtracting any withdrawals. Throughout that period, BLMIS reported fictitious "profits" in each and every year, which were credited to the net asset value of the 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.

14. 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. § 78EEEE(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.

15. The revelation of the Madoff thefts had a significant impact on Beacon I. First, 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 Madoff fictitious profits. An investor with a 1% “sharing ratio” in the Beacon Funds before the write-down, continued to have a 1% interest in the Beacon Funds 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.

16. On December 18, 2008, Beacon Management determined to liquidate the Beacon Funds. Because approximately 25% of the balance of assets remaining in Beacon I 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 it would distribute funds remaining in the Beacon Funds to all investors on or about July 15, 2009.

THE PROCEDURAL HISTORY OF THE VALUATION DISPUTES

17. As a result of a dispute that arose over the proper methodology to follow in valuing the capital balances attributable to individual Fund investors for purposes of distribution

of the non-Madoff invested funds, the Beacon Funds commenced an action captioned *Beacon Associates Management Corp. v. Beacon Associates LLC I*, No. 09 Civ. 6910. The Fastenberg Intervenors 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' then remaining assets, which were then exclusively the proceeds of investments made by the Beacon Funds with managers other than Madoff, using the Valuation Method. The "Valuation Method," "treats the Madoff losses as though they occurred due to "market fluctuations," that is, the Madoff-related losses are reported as having occurred in December 2008 (the date of discovery) and, pursuant to Beacon's Operating Agreement, allocated to each member on a pro-rata basis." *Beacon Assocs. Mgmt. Corp. v. Beacon Assocs. LLC I*, 725 F. Supp. 2d 451, 454 (S.D.N.Y. 2010).

18. 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.

19. 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*"). 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 State 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 (collectively the "*Beacon Actions*").

20. The *Beacon Actions* and the *Trustee's Claw-Back Action* were settled. Payment was made to the Trustee to settle the *Trustee's Claw-Back Action*. The defendants in the *Beacon Actions* paid to settle the claims against them. Distribution of the settlement proceeds of the *Beacon Actions* were made using the Net Equity Method, and not the Valuation Method to individual investors including all investors in the Beacon Funds who had Net Equity balances. 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. 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.

21. 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 to the Beacon Funds its pro rata share of portions of the amounts recovered by the Trustee for the BLMIS Estate. The Trustee computed the pro rata share of each investor's recovery, including the recovery by the Beacon Funds, using the Net Investment Method.

THIS ACTION, BEACON II

22. 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 Civ. 2294, seeking to have the Court order

the proper method of distribution of the recoveries from the Madoff Trustee and various suits. (hereinafter “*Beacon II*”). *Beacon II* presented the Court with a different equitable issue than the distribution on non-Madoff money which was at issue in *Beacon I*. Following notice to all Beacon Fund Investors and briefing on the issues by all interested parties, including Defendant Fastenberg and Defendant Income Plus Investment Fund, the Court held a hearing on October 7, 2014. At the hearing the Court ruled that until investors received a return of all of their principle invested, all of the “Madoff” recoveries, including the amounts from the Madoff Trustee and “the various court actions in Nassau, etc., that we referred to, should be distributed based on the cash in, cash out method, also referred to as the net investment method.” . Ex. A at 44:15-18. The Court also held that “The amounts already received by the Beacon fund participants through the class action settlement...should be included within that as money recovered by those who did recover.” *Id.* at 44:18-22. The amounts to be distributed after all investors have received return of all of their principle invested will be distributed by the Valuation Method. The rulings were incorporated into an order dated October 31, 2014, which defined the cash in/cash out method as the “Net Equity Method” and defined the point at which all investors received return of all of their principle invested as the “Net Equity Break Even Point.” Ex. B at 4.

23. According to the Beacon Fund documents and schedules I have reviewed, the 19 accounts subject to holdbacks have had distributions totaling \$4,297,559 held back from distribution, although \$261,051 is being held back for unrelated reasons, and will be

distributed after the proper recipient is clearly identified.⁴ The Beacon Funds have computed that approximately \$19 million will be required to be distributed to bring all investors up to Net Equity Break Even Point.

24. The hold backs at issue fall into three broad categories: the AIJED related accounts, the accounts of investors who originally invested in Beacon through a feeder fund called First Frontier, several accounts which were identified as related by the Brattle Group, experts hired for the class action settlement, but not previously treated as related by the Beacon Funds.

The AIJED Accounts

25. The AIJED account issues relate primarily to two related entities, AIJED Associates LLC (“AIJED I”) and AIJED International Ltd. (“AIJED II”) and (collectively “AIJED”). Beacon’s schedules show that prior to any adjustment, AIJED I has a *negative net equity* of approximately \$7.7 million, while AIJED II had a positive net equity of \$4.7 million⁵. Collectively, AIJED I and AIJED II were approximately \$3 million ahead. Those schedules also show that unless the amount due to AIJED II is adjusted, AIJED II will receive a distribution of in excess of \$3.5 million, and the AIJED accounts will be over \$6.5 ahead, while other investors will still have more than \$19 million of their principle cash invested not yet repaid.

⁴ That amount is held back from the accounts of Ian Moss and Beverly Fienberg, who were previously married, and are now divorced, because there are unresolved questions about who should receive the distributions and in what amount.

⁵ According to the Beacon Fund’s computations, prior to the 2010 distributions and the Class Action Settlement, AIJED II had \$10 million of Net Equity in the Beacon Funds. A \$5 million payment from the Class Action Settlement, and distributions of non-Madoff recoveries in 2010 and 2013, together with a credit for the settlement of Beacon Funds Management Fee amount, reduced that amount to the \$4.7 million amount. See, Exhibit D hereto.

26. According to the Beacon Funds and AIJED's schedules, and my interview with AIJED management, AIJED I was a fund of funds investment fund which invested in the Beacon Funds starting in 1997. It also invested in other investment funds. AIJED II was started in July 2005 as an off shore investment vehicle, investing primarily, but not exclusively, with the same investment managers and using substantially the same investment strategies as did AIJED I, with some adjustments to take into account the potential tax advantages of investment through an off shore vehicle. AIJED II was marketed to the investors in AIJED I and, as shown on AIJED's own schedule, Exhibit E hereto, one hundred per cent (100%) of the capital invested in AIJED II, approximately \$25 million, came from AIJED I. Over \$6.9 million was transferred from the Beacon account for AIJED I to a new account established at Beacon for AIJED II. The balance came from, and was invested with, other investment funds. In 2006 \$500,000 was withdrawn from the AIJED I account at Beacon, and the identical amount was invested in the AIJED II account at Beacon. In 2007, a total of approximately \$4.6 million was withdrawn from the AIJED I and AIJED II accounts at Beacon. In 2008, \$5 million was invested in the AIJED II account at Beacon. If the two accounts are considered to be merged, then collectively the AIJED accounts have a combined *negative net equity* of \$2,977,565.

27. The Beacon Funds have computed that at the time of the opening of AIJED II, AIJED I had "profits" of \$6.4 million. In making its initial computations of the Net Equity balances, the Beacon Funds treated the transfer of \$6.9 million from AIJED I to AIJED II, as if AIJED had withdrawn its profits first. However, the Beacon Funds have also computed the effect on Net Equity if the "profits" were allocated between the two accounts based upon the relative net asset value, the amount shown on the account statements including profits, of the two accounts. Prior to the transfer, AIJED I showed a net asset value of approximately \$20.5 million,

and the approximately \$7 million transferred to AIJED II was 34.10 percent of that amount. If that number is used, than AIJED II received only \$2 million in Net Equity as a result of the transfer, not \$6.9 million, and AIJED II kept the rest. Re-computing the Net Equity using those numbers leaves both AIJED I and AIJED II with *negative net equity* (\$2,908,906 and \$68,659 respectively). See, Exhibit D hereto.

The First Frontier Investors

28. The First Frontier investors at issue account for \$133,193 of the holdbacks. Those investors initially invested in the Beacon Funds only indirectly, through an investment in First Frontier, which, in turn, invested their money into the Beacon Funds. See, Exhibit G. Each of those investors were clients of Family Management Corporation, an investment advisory business. The investments were first made on or about April 11, 2002. Prior to April 2004, Family Management arranged with Beacon to take its First Frontier clients as direct investors in the Beacon Funds. The money from these investors was withdrawn from First Frontier and invested in individual accounts for the investors at the Beacon Funds. The Beacon Funds initially computed the Net Equity of these investors using the full amount of the investment, which included the “profits” made at First Frontier. The Beacon Funds have now computed the amount of the “profits” and held back that amount for distribution. *Id.*

Karin Stoller

29. Karin Stoller was a First Frontier Investor who also closed and later re-opened an account at the Beacon Funds. At the time of the opening of her direct account in April 2002, she deposited \$340,153, of which \$15,193 was “profit” earned at First Frontier. She subsequently added additional capital, and withdrew all money and closed her account in April 2005. In October 2005, she opened a new account, but only deposited less than half the amount she had

withdrawn. I have had a schedule prepared under my direction doing the If the same proportionate allocation of cash basis is for Stoller's account as the Beacon Funds did for the AIJED accounts. That computation, which is annexed hereto as Exhibit I, shows that approximately 43% of the cash basis in the closed account would be transferred to the new Stoller account, thereby reducing the carried over Net Equity by 43% as well. As a result, Stoller should still have a holdback, but the holdback should be substantially lower than the amount shown on the Beacon Fund computations.

The Brattle Group Adjustments

30. During the negotiation of the details of the Class Action Settlement and the Class Action distribution, the Brattle Group worked with the Beacon Funds to seek to identify accounts which were closed and later opened by the same or substantially the same party for the purpose of adjusting the Net Equity balance for the second account, to reflect profits earned in the first account. They identified five accounts, including Stoller, which fell into that category. The Beacon Funds had not previously adjusted its books to reflect the same accounting treatment, but since prior distributions "non-Madoff money" were made using the Valuation Method, there was no real need to dive deeply into the facts at those time.

31. During the discussions of the accounting adjustments required by the transfer of funds between related accounts, I was not aware, and I do not believe other counsel or Lynda Borucki of the Brattle Group was aware, or even that the Beacon Funds were fully aware, of the full history and complex interrelationship between AIJED I and AIJED II.

32. At the time, the AIJED I account was in liquidation, and referred to as "SALT" which stood for Special Asset Liquidating Trust. Further, until discovery in this action, I was not aware, and it is not clear that the Beacon Funds were aware that 100% of the AIJED II starting

capital was contributed by AIJED I. Moreover, the Brattle Group was not trying to make equitable adjustments, but only the narrower analysis of whether the transferor and the transferee were essentially the same entity or so closely related as to legally be treated as such.

33. I was also part of the mediation and negotiations between the Beacon Funds and the SIPC Trustee concerning the settlement of the SIPC Trustee's claims. During that negotiation, the Beacon Funds made the arguments that the Trustee should "look through" the Beacon entity and recognize that distributions and withdrawals by Beacon from Bernard L. Madoff Investment Securities, LLC, were in essence distributions and withdrawal by different investors in Beacon. The Trustee was firm in his disregard of the working of investments within Beacon, and that action settled in a manner which treated the Beacon Funds as entities only, disregarding the separate interests of the underlying investors.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 13, 2015

New York City, New York

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

Max Folkenflik