

SECURITIES INVESTOR PROTECTION
CORPORATION
805 Fifteenth Street, N.W., Suite 800
Washington, D.C. 20005-2207
Telephone: (202) 371-8300
JOSEPHINE WANG
General Counsel
Email: jwang@sipc.org
KEVIN H. BELL
Senior Associate General Counsel for Dispute Resolution
Email: kbell@sipc.org
CHRISTOPHER H. LAROSA
Senior Associate General Counsel-Litigation
Email: clarosa@sipc.org

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

_____)	
SECURITIES INVESTOR PROTECTION)	
CORPORATION,)	Adv. Proc. No. 08-1789 (BRL)
)	SIPA Liquidation
Plaintiff-Applicant,)	
)	(Substantively Consolidated)
v.)	
)	
BERNARD L. MADOFF INVESTMENT)	
SECURITIES LLC,)	
_____)	
Defendant.)	
)	
IN RE:)	
)	
BERNARD L. MADOFF,)	
)	
Debtor.)	
_____)	

**MEMORANDUM OF THE SECURITIES INVESTOR PROTECTION CORPORATION
IN SUPPORT OF THE TRUSTEE'S MOTION TO AFFIRM HIS TREATMENT OF
PROFIT WITHDRAWALS**

TABLE OF AUTHORITIES

<u>CASES:</u>	<u>PAGE</u>
<i>ACE Secs. Corp. v. DB Structured Products, Inc.</i> , -- N.E.3d --, 2015 WL 3616244 (N.Y. June 11, 2015).....	7
<i>In re Adler Coleman Clearing Corp.</i> , 198 B.R. 70 (Bankr. S.D.N.Y. 1996)	5
<i>In re Adler Coleman Clearing Corp.</i> , 204 B.R. 111 (Bankr. S.D.N.Y. 1997)	9
<i>Appleton v. First Nat’l Bank of Ohio</i> , 62 F.3d 791 (6 th Cir. 1995).....	4
<i>In re A.R. Baron Co., Inc.</i> , 226 B.R. 790 (Bankr. S.D.N.Y. 1998).....	9
<i>In re Bernard L. Madoff Inv. Secs. LLC</i> , 654 F.3d 229 (2d Cir. 2011), <i>cert. dismissed</i> , 132 S. Ct. 2712 (2012) and <i>cert. denied</i> , 133 S. Ct. 24 and 133 S. Ct. 25 (2012).....	3, 4
<i>CarVal Inv’rs UK ltd. v. Giddens (In re Lehman Bros., Inc.)</i> , 506 B.R. 346 (S.D.N.Y. 2014), <i>aff’d</i> , -- F.3d --, 2015 WL 3938079 (2d Cir. Jun. 29, 2015).....	9
<i>Chigirinskiy v. Panchenkova</i> , 2015 WL 1454646 (S.D.N.Y. March 31, 2015)	7, 8
<i>In re John Dawson & Assocs., Inc.</i> , 289 B.R. 654 (Bankr. N.D. Ill. 2003).....	5
<i>In re Klein, Maus & Shire, Inc.</i> , 301 B.R. 408 (Bankr. S.D.N.Y. 2003).....	5
<i>Luitpold Pharmaceuticals, Inc. v. Ed. Geistlich Söhne A.G. Für Chemische Industrie</i> , 784 F.3d 78 (2d Cir. 2015).....	7, 8
<i>In re Mason Hill & Co., Inc.</i> , 2004 WL 2659579 (Bankr. S.D.N.Y. Oct. 18, 2004).....	5, 6
<i>Modern Settings, Inc. v. Prudential-Bach Secs., Inc.</i> , 936 F.2d 640 (2d Cir. 1991)	6, 7
<i>Mosdos Chofetz Chaim, Inc. v. RBS Citizens, N.A.</i> , 14 F. Supp. 3d 191 (S.D.N.Y. 2014)	7
<i>Pitheckoff v. Sec. Inv’r Prot. Corp. (In re Great Eastern Secs., Inc.)</i> , 2011 WL 1345152 (S.D.N.Y. Apr. 5, 2011).....	5, 6
<i>In re Primeline Secs. Corp.</i> , 295 F.3d 1100 (10 th Cir. 2002).....	9
<i>In re Rausman</i> , 855 N.Y.S.2d 263 (N.Y. App. Div. 2008).....	7
<i>Regions Bank v. Wieder & Mastroianni, P.C.</i> , 526 F. Supp. 2d 411 (S.D.N.Y. 2007), <i>aff’d</i> , 268 F. App’x 17 (2d Cir. 2008).....	7

TABLE OF AUTHORITIES

cont.

STATUTES AND RULES:

PAGE

Securities Investor Protection Act, as amended, 15 U.S.C. §

78fff-2(b).....8

Securities Investor Protection Act (2008), 15 U.S.C. §

78III(2).....4

78III(2)(B).....4

78III(4).....5

N.Y. C.P.L.R. § 213(2).....7

PUBLICATIONS AND TREATISES:

Joseph M. McLaughlin, Jack B. Weinstein, Margaret A. Berger,

2 Weinstein's Fed. Evid. § 406.03 (2d ed. 2014).....10

BACKGROUND

The facts underlying the Trustee's Motion are aptly and expansively discussed in the Trustee's memorandum. In brief summary, each of the Claimants who object to the Trustee's Motion entered into a "Customer Agreement" with BLMIS. The agreement signed by each of the Claimants included a paragraph requiring the customer to object in writing to the contents of an account statement within ten (10) days of receipt thereof. That paragraph provided, in full, as follows:

CONFIRMATIONS AND STATEMENTS

Confirmations of transactions and statements for the Customer's Account(s) shall be binding upon the Customer if the Customer does not object, in writing, within ten days after receipt by the Customer. Notice or other communications including margin and maintenance calls delivered or mailed to the address given below shall, until the broker has received notice in writing of a different address, be deemed to have been personally delivered to the Customer whether actually received or not.

(*See, e.g.*, Declaration of Vineet Sehgal §§ 6-8, Ex. 2-4 § 16.)

BLMIS issued periodic account statements to investors with accounts at the firm, including Claimants. Claimants have not denied receiving any of the account statements issued by BLMIS with respect to their accounts, including those implicated by the Trustee's Motion.

The account statements issued by BLMIS to its account-holders identified "transaction types" and "transaction descriptions." (*See* Expert Report of Lisa M. Collura ("Collura Rep.") § 7; Expert Report of Matthew B. Greenblatt ("Greenblatt Rep.") ¶ 6.) Transaction type notations included: "PW" for profit withdrawal; "CW" for cash withdrawal; or "JRNL" for journal entries. (*See* Collura Rep. at ¶ 7; Greenblatt Rep. at ¶¶ 6, 23-24) Where BLMIS customer statements indicated a "PW" transaction type, the transaction description field generally contained one or more of the words "CHECK," "DIVIDEND," or "INTEREST," sometimes following or preceding a company name, for example, "CHECK VIACOM." (*See* Greenblatt Rep. at ¶¶ 6,

Filing, Determination, and Adjudication of Claims; and Providing Other Relief (“Procedures Order”), the Trustee issued and mailed to each of the Claimants a Determination describing his disposition of the relevant claim and the basis for the same. (*See* ECF 12 at 6-7.) Claimants objected to those Determinations, but have produced no evidence that, prior to the commencement of this liquidation, they complained at any time to BLMIS about any of the Profit Withdrawal Transactions. Through his Motion, the Trustee seeks entry of an order affirming his net equity computations to the extent based upon his treatment of Profit Withdrawal Transactions as cash withdrawals.

ARGUMENT

I. Claimants ratified the Profit Withdrawal Transactions

“Customer” status under SIPA is contingent upon the entrustment of cash or securities to the broker-dealer for the securities account of an investor for one or more purposes identified in SIPA. *See* SIPA §§ 78III(2) (2008) (customer is a person who has a claim on account of securities received, acquired, or held for the securities account of such person “with a view to sale, to cover consummated sales, pursuant to purchase, as collateral security, or for purposes of effecting transfer”); 78III(2)(B) (2008) (“The term ‘customer’ includes—any person who has deposited cash with the debtor for the purpose of purchasing securities”). *See also, e.g., BLMIS*, 654 F.3d at 236 (“[T]he critical aspect of the ‘customer’ definition is the entrustment of cash or securities to the broker-dealer *for the purposes of trading securities*” (*quoting Appleton v. First Nat’l Bank of Ohio*, 62 F.3d 791, 801 (6th Cir. 1995) (emphasis added by Second Circuit)); *Stafford v. Giddens (In re New Times Secs. Servs., Inc.)*, 463 F.3d 125, 128 (2d Cir. 2006) (same). Such status also may arise from the conversion of assets that were held by the broker-dealer for a customer. *See* SIPA §§ 78III(2) (2008) (extending “customer” status to “any person

“Customer” status is unavailable, however, with respect to an unauthorized account transaction ratified by an investor. *See, e.g., Mason Hill*, 2004 WL 2659579, at * 6. An investor ratifies an unauthorized transaction by acquiescing in it, and will be found to have acquiesced if the investor knew the pertinent facts surrounding the trade and manifested a clear intent to approve it. *See, e.g., Great Eastern*, 2011 WL 1345152, at * 6; *Richardson Greenshields Secs., Inc. v. Lau*, 819 F. Supp. 1246, 1259 (S.D.N.Y. 1993). Failure to object to a transaction over a long period of time is compelling evidence of such intent. *See Great Eastern*, 2011 WL 1345152, at * 6; *Greenshields*, 819 F.Supp. at 1259. Moreover, if the investor knew of the challenged transaction, the investor bears the burden to demonstrate that this knowledge did not rise to the level of ratification. *See Great Eastern*, 2011 WL 1345152, at * 6; *Greenshields*, 819 F. Supp. at 1259.

Ratification may be deemed to have occurred as a matter of law if the contract between a broker-dealer and an investor requires the investor to object in writing within a specified period of time – usually ten days - to a transaction reflected on an account statement, trade confirmation, or other communication from the broker-dealer. *See, e.g., Modern Settings, Inc. v. Prudential-Bach Secs., Inc.*, 936 F.2d 640, 645-46 (2d Cir. 1991); *Great Eastern*, 2011 WL 1345152, at * 6; *Mason Hill*, 2004 WL 2659579, at * 6. Enforcement of these provisions prevents the “cherry picking” of transactions by an investor after the fact and mitigates the prospect of an evidentiary vacuum in post-trade disputes between investor and customer. *See Modern Settings*, 936 F.2d at 645-46; *Mason Hill*, 2004 WL 2659579 at * 6. The Second Circuit explained this rationale in detail in *Modern Settings*:

The purpose of the ten-day written complaint clause in the customer agreement is to require the customer to memorialize his or her complaint soon after receipt of the account statement rather than waiting to see if the trade is profitable. The writing requirement of the clause insures that unauthorized trading disputes are

II. Claimants cannot sustain their burden of proof

As noted, in compliance with the Procedures Order, the Trustee issued to each of the Claimants a written Determination describing his disposition of the Claimant's claim and the reasons therefor. Under SIPA, Claimants now have the burden to rebut the Trustee's reasons and to demonstrate how the claim should have been determined. *See, e.g., Sec. Inv'r. Prot. Corp. v. Bernard L. Madoff Inv. Secs. LLC*, 515 B.R. 161, 166 (Bankr. S.D.N.Y. 2014) (Bernstein, J.) ("The [customer] claimant [under SIPA] has the burden to establish his status as a 'customer,' and such a showing is not easily met" (citations omitted)).

Allocation of the burden of proof to the claimant arises from the language of SIPA. SIPA provides that a trustee is obligated to satisfy customer claims for net equity to the extent a broker's obligations are ascertainable from the books and records of the debtor or "are otherwise established to the satisfaction of the trustee." *See* SIPA § 78fff-2(b). The emphasis in this language on the debtor's "books and records" and the extent of the broker's obligations indicates that the language encompasses both the nature *and* amount of the debtor's obligations. Moreover, the quoted language indicates that a claimant challenging a trustee's claim determination must rebut that determination "to the satisfaction of the trustee," *i.e.*, must bear the burden to demonstrate that the trustee's determination is in error and to establish the correct

prior to the commencement of the SIPA proceeding on December 11, 2008, would place their claims outside of the limitations period for conversion. *See Chigirinskiy*, 2015 WL 1454646 at *16. Likewise, any of the Profit Withdrawal Transactions that occurred more than six years prior to December 11, 2008 falls outside the limitations period for breach of contract. *See, e.g., Luitpold*, 784 F.3d at 97. Accordingly, as a matter of law, Claimants would not have a viable "customer" claim for any such transaction that occurred before December 11, 2002, at the earliest.

example, for the period from December 1998 through December 2008, the Trustee's experts have determined that, in nearly all cases, the Profit Withdrawal notations on account statements issued by BLMIS to its customers correspond to BLMIS and investor bank records demonstrating delivery to investors of funds in the amounts shown on the statements. That evidence is sufficient both to establish receipt by Claimants of the amounts now challenged by them, particularly in the absence of any compelling documentary evidence to the contrary.

It is also sufficient to demonstrate that BLMIS maintained a consistent corporate practice of sending investor funds in the amounts reflected in corresponding Profit Withdrawal notations on the account statements issued and mailed to the same investors. Under Rule 406 of the Federal Rules of Evidence, the existence of that practice over a ten-year period is sufficient to support the inference that BLMIS maintained the same practice prior to 1998 and that the Profit Withdrawal notations on account statements issued for earlier periods are also accurate. *See* Fed. R. Evid. 406 ("Evidence of a person's habit or an organization's routine practice may be admitted to prove that on a particular occasion the person or organization acted in accordance with the habit or routine practice"). *See also, e.g., U.S. Information Systems, Inc. v. Int'l Bhd. of Elec. Workers Local Union Number 3, AFL-CIO*, 2006 WL 2136249, at * 18 (S.D.N.Y. Aug. 1, 2006) ("Routine practice evidence is more probative than character evidence because routines consist of automatic, nonvolitional acts"); Joseph M. McLaughlin, Jack B. Weinstein, Margaret A. Berger, 2 *Weinstein's Fed. Evid.* § 406.03 (2d ed. 2014) ("Evidence of a routine practice is particularly persuasive in the business context because of the profit-driven need for regularity"). In addition, for the reasons discussed in detail in the Trustee's memorandum, expert extrapolation from existing evidence is both permissible and persuasive in a Ponzi scheme featuring incomplete records.