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More On Net Equity - Plus Picower
National Affairs
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In accordance with the briefing schedule set by the Bankruptcy Court, the Trustee's brief on the question of net equity will be submitted shortly. A month later briefs opposing him will be filed. Briefs filed on net equity in the past by Picard's opponents seem to me very good and, in toto, pretty complete. While one does not yet know what the Trustee will say, because his prior work generally has not focused on defending his definition of net equity (although he *has* discussed his position a *bit* on his website and in some briefs), one can expect that the opponents will reiterate the (very strong) points they have previously made and may add some new ones if they do come up with new ones. And they almost certainly will specifically retort to points the Trustee makes.

In reading what little the Trustee has said in the past to justify his cash-in / cash-out position on net equity, a couple of thoughts struck me that, as far as I can recollect, have thus far not been made by opponents. I shall set them forth here.

The Trustee has said from early-on that cash-in / cash-out is justified because persons who took out money from Madoff received money put in by other investors. True, but he neglects to mention that the money put in by persons who also took out money was *likewise* used to pay other investors. Some of those other investors were prior ones, but some might even have been *subsequent* ones because, up until the last year or so,

Madoff appears to have had 17 to 20 billion dollars in his account at JP Morgan Chase. The meaning of all this is that, for example, if someone invested one million dollars in 2001, her money was used to pay off other investors, many or all of whom took out more than they put in, just as other people's money was used to pay *her* when *she* later took out sums that could have been equal to or more than she put in.

What I am trying to say here is that Picard's model is, in effect, simple minded because it neglects portions of the reality. His comments, you know, have the aura of blaming people who took out more than they put in, because, he says, they received other people's money and therefore should get nothing. He does not mention that, correlatively, other people received *their* money - and, if these others cashed out completely over six years ago, will never have to repay the money.

This brings me to the legitimate expectations of investors, denoted by the sums shown on their November 30th statements. Much has already been written about legitimate expectations in briefs and blogs, but let me add one point that has rarely if ever been *explicitly* mentioned, although often it has seemed *implicit* to me. The point in mind is this: even aside from the fact that Congress mandated it, why *should* the amounts shown as owing to her in statements received by an innocent investor be considered her legitimate expectation? The answer, though quintessentially simple, is overlooked by Picard and almost everyone else too. It is that the innocent investor, like anyone else, plans her life around the amounts of money that she justifiably believes she has, including the amount shown on her statement. Her purchases, her expenditures - everything gets planned around the amount of money she thinks she has, including what is shown on her statements. That is why the amount shown in the statement *must* be considered the net equity of an *innocent* investor who never suspected fraud (this would not include the Picowers and Chaises) unless you are in the business of screwing people. The innocent person made her plans based on what she legitimately thought she had - knowing of course that she is subject to *market* risk, as everyone is in investments, but never having any reason to suspect fraud - a fraud which continued only because the government she relied on was so phenomenally negligent that its failure to catch Madoff was defacto intentional.

Just this week a lawyer explained to me a point which I shall use to further support my point. I don't know that the lawyer has yet written the point in a brief - the lawyer may or may not have. I am confident it will appear in future briefs, but don't know if the lawyer wishes to be identified now, so I won't identify the attorney and will say only that I thought the point most salient.

Suppose, said the attorney, you have put $100,000 into a bank, and over the years received statements saying that (because of interest) you now have $150,000 in your account. Then the bank declares bankruptcy, and the FDIC says it will only pay you $100,000 because the bank was insolvent the whole time and so the interest credited to your account was phantom interest, phantom profit. You would hear the screams from here to Washington, and you can pretty well rest assured that the FDIC would not be allowed to get away with this. Well, what the FDIC is attempting in this hypothetical example is what the Trustee is attempting here.

The situation would be even closer if the FDIC, in the example, were acting to save itself because it will run out of money, as may be - and I think *is* - what accounts for

SIPC's action here, as has been discussed in a prior post.

Let me make yet one other point regarding net equity. So far people - including me - seem to have been operating under the assumption that if you have a negative net equity for purposes of SIPC, which so many do under Picard's cash-in / cash-out theory, then not only do you fail to get any money from SIPC, but you also have no right to any share of the estate, to any share of what I gather is called customer property by Picard and Harbeck. Put differently, what is net equity for SIPC purposes also controls for bankruptcy purposes: No net equity for SIPC purposes means no share in the bankruptcy estate. But reading some cases cited by Picard for his cash-in / cash-out theory makes me wonder whether this is necessarily true; makes me wonder whether what is net equity for SIPC purposes does control what one's share of the bankruptcy estate is. The cases cited by Picard were *not* SIPC cases; they were bankruptcy cases. For bankruptcy law, cash-in / cash-out might make some sense, because legitimate expectations, which are a linchpin of net equity under SIPC pursuant to both Congressional intent and case law, conceivably seem not pertinent in bankruptcy. So I would think it at least conceivable that under the law someone might have a positive net equity under SIPC because her November 30th statement is the legitimate expectation and the measure of net equity, yet have little or no interest in the bankruptcy estate because she took out more from Madoff than she put in. It *may* be that all of us, Picard included, have wrongly been conflating two ideas that are not necessarily the same.

Perhaps it is also possible that Picard is conflating the two ideas deliberately because he knows, as one expert told me (I *think* I understand him correctly), that clawbacks in bankruptcy are limited to 90 days. By using cash-in / cash-out to arrive at a negative net equity, and by using that negative net equity as the measure of a person's relationship to the estate, it is suggested (*if* I understand things rightly) that Picard is putting someone who received a nonfraudulent preference in the position of owing money to the estate. The money may not be collectible because of timing rules, I gather, but at least the investor won't have to be *paid* money by the estate (if I understand right, which may be questionable).

Let me close with a brief point which is on a different subject than net equity, but which relates to the Trustee. For months I have wondered - and have written of the wonderment - why Madoff had given what apparently is more than seven billion dollars to a guy who put in only about $1.5 billion, Jeffry Picower. The only thing I could think of was that maybe Picower was fronting for the Mafia or for one or more secret services. But someone has now told me a different possible reason which has an immediate ring of truth, though one cannot yet know if it *is* true and can only hope that Picard, the FBI and the U.S. Attorney are all tracking it down.

Picower used to specialize in promoting tax shelters. Did his tax shelters, as many do, involve foreign countries or foreign institutions in some way? Did he, like so many involved with shelters, meet all kinds of persons who are in the business of sheltering funds here and abroad for wealthy taxpayers. For maybe, you see, Madoff was sending all this money to Picower to hide it overseas for him. *That* would make sense. If it happened, it may be hard to trace the money to its final destination. Or maybe not, since there are records of bank transfers. One can only hope that Picard, the FBI and the U.S. Attorney are all looking into this because the idea that Madoff was sending

money to a former tax shelter expert to hide it for him overseas may be far and away the best conjecture on why Madoff would send over seven billion dollars to someone who put in only about $1.5 billion.

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