WILLIAM A. DESPO

DESPO LAW GROUP

Suite One
36 Bingham Avenue
Rumson, New Jersey 07760

Alerts

Client Alert: More Headaches on the Way for Madoff Investors

Related Attorneys
William Despo
Todd Galante
William Oberdorf

01/20/2009

The Bernard Madoff Ponzi scheme was announced on December 11, 2008, and already, much has transpired. The U.S. Justice Department has a criminal action pending against Madoff, the U.S. Securities Exchange Commission has an enforcement action against him and his brokerage firm, and numerous suits have been filed against various parties. Bernard L. Madoff Securities, LLC is now in bankruptcy and a Trustee has been appointed. The Trustee recently sent claim forms to customers of Madoff Securities in order to provide them with information on how to take advantage of insurance protection that is available from the Securities Investment Protection Corporation.

What lies ahead for investors? Investors are likely to be faced with a lawsuit by the Trustee seeking the return of some or all of the proceeds they received from Madoff Securities. As an example, in another recent Ponzi scheme, the trustee brought suit against more than 10,000 investors for the return of proceeds received from the Ponzi scheme operator.

On the basis of fraudulent transfer laws, the Trustee can pursue investors to recover money paid to them. Under Section 548 of the Bankruptcy Code, the Trustee may avoid any transfer of monies from the Ponzi scheme operator made within two (2) years prior to the date of filing of a petition in Bankruptcy. Under similar state statutes, the Trustee can go back even longer, up to six (6) years in some cases. Other actions can also be initiated. Under fraudulent conveyance law, as long as the transfer of payment was made with the intent to hinder, delay, or defraud a bankrupt entity, the Trustee can seek to recover funds.

Unfortunately, for the investors, the courts have determined that actual fraud always exists in a Ponzi scheme. Based on this theory, the Trustee can seek to recover all the amounts that have been paid to the investor, both principal and any return on the investment. Other theories of recovery also exist. In any event, lawsuits are on their way.

The investor must then defend the suit or be subject to entry of default judgment. The investor can try to avail himself of certain defenses, including one based on "good faith." In this instance, if the investor can prove that payments were received in good faith, the Trustee will only be able to recover profits, not any principal that was returned to the investor. A good faith defense will be judged by an objective standard, that is, the investor must prove that he did not know and should not have known of the debtor's Ponzi scheme. One of the factors that determines whether the investor should have known that a Ponzi scheme was in place will be an analysis of the profits promised in contrast to returns that can be obtained under actual market conditions.

If the investor successfully proves a good faith defense, the Trustee's recovery will be limited to the amount of profits received and the investor will be able to retain any principal repayments.

The Trustee can also proceed based on the theory of "constructive fraud" under the fraudulent transfer laws. However, under this theory, the Trustee can only recover profits paid to the investor, not the principal.

The Trustee also has another option in attempting to recover money from investors. Under the bankruptcy law provisions, the Trustee can seek to recover, as a preference payment, any payment to the investor made within ninety (90) days of filing the petition in the bankruptcy case. This period can be extended to one (1) year for "insiders." Depending on the facts, the investor may have defenses available to this action.

Where will all this "recaptured" money go?

Eventually, after the expenses of the bankruptcy case and litigations are paid, the money will go back to claimants and investors. The leftover funds will be distributed pro rata, on the basis of valid claims against Madoff Securities, and in order of priority established under the Bankruptcy Code.

It is clear that another headache awaits the investors in this Ponzi scheme... defending themselves from lawsuits brought by the Trustee.

E-MAIL: Bill@WDespoLaw.com
Cell: 732-977-4659

Direct: 732-945-5178
Fax: 732-945-4000