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Start Date of Ponzi Scheme Is Critical to Claims

Bernard L. Madoff's enormous Ponzi scheme ended on Dec. 11, 2008, when he was arrested at his Manhattan penthouse. But for some early victims, the date his crime started could matter much more than when it stopped, The New York Times's Diana B. Henriques writes.

A motion pending in Federal Bankruptcy Court in Manhattan contends that Mr. Madoff's long-term investors cannot accurately calculate their losses until they know whether any of their original profits were legitimate. And to determine that, the motion continues, they must know when the Ponzi scheme began.

The Madoff bankruptcy trustee is calculating investor losses as the difference between the cash paid into an account and the cash taken out.

But if some of an investor's early profits were in fact legitimate, those earnings should count as part of the cash paid into the Ponzi scheme, the motion argues.

Doing that would mean that some people who do not have a valid claim now — because they took out more than they paid in — could suddenly become “net losers” who got back less than they put in.

Of the 4,903 accounts on the Madoff books, 2,568 of them are classified as net winners with no valid claims.

Depending on the size of their loss, net losers can get up to \$500,000 from the Securities Investor Protection Corporation, an industry-financed reimbursement fund, and a share of whatever assets the trustee can collect.

Even some investors already eligible for SIPC compensation could get more if they were credited with legitimate profits earned before the Ponzi scheme began, the motion asserts.

The novel argument is being made by Therese M. Doherty and John Oleske at the firm of **Herrick, Feinstein** in New York. They represent an obscure, insolvent company called **Magnify Inc.**, which is not related to two other identically named companies in the United States.

“I can confirm that Herrick's client was a direct investor” with Mr. Madoff since at least 1979, Ms. Doherty said. “Our client has requested that we not further identify it in any

way, or discuss the facts relating to its investments.”

The Herrick team argues that “the information available to date” points to a starting date for the fraud sometime in the early 1990s — by which point Magnify already had “a substantial amount” of legitimate profits in its Madoff account, according to the motion.

But that is only one of the publicly available answers to the question of when the fraud started.

Mr. Madoff, in the sworn statement he made when he pleaded guilty in March, said his fraud began in the early 1990s. When his key lieutenant, Frank DiPascali Jr., pleaded guilty in August, he told the judge his crime may have started a few years earlier than that, perhaps in 1989.

Indeed, since Mr. Madoff was accused of giving special treatment to some long-term investors, it is possible that some accounts became part of the Ponzi scheme later than others.

But in court statements and filings, federal prosecutors have consistently asserted that the entire Ponzi scheme was up and running “at least by the 1980s.”

They made that estimate long before the bankruptcy trustee had reconstructed the Madoff account records for the 1980s — even now, only records going back to 1983 are completed. And prosecutors declined recently to explain why they were so certain, even though the date could be quite significant for some Madoff victims.

But other lawyers are clearly intrigued by the Magnify argument. “It is an interesting, novel and potentially very important thesis that makes perfect sense,” said Richard Levy Jr., whose firm represents some Madoff victims.

“There had to be a starting point,” Mr. Levy continued. “If it wasn’t a Ponzi scheme from the start, I don’t see how you can dismiss the legitimate profits from the initial investments.”

The Magnify motion demands that Irving H. Picard, the trustee liquidating the Madoff estate for SIPC, produce a valid starting date for the fraud before he determines the claims of investors whose accounts may predate the Ponzi scheme.

The Herrick filing also echoes more familiar arguments being made by dozens of other lawyers disputing the way Mr. Picard is calculating investor losses.

Those motions argue that Mr. Picard is violating the SIPC statute and earlier court rulings by calculating investor losses on a “cash-in, cash-out” basis rather using the balances shown on customer account statements before Mr. Madoff’s arrest.

The sum of all of those individual account balances was more than \$64 billion. By

contrast, Mr. Picard has said that the eligible losses in the fraud, by his formula, total just over \$21 billion.

This so-called net equity dispute, which has generated fierce debate among Madoff victims since last spring, is scheduled to come before Judge Burton R. Lifland of United States Bankruptcy Court in Manhattan on Feb. 2.

Lawyers on both sides of the dispute say that any decision by Judge Lifland is certain to be appealed at least to the federal appellate court in New York, which could take up to a year to reach a decision.

Mr. Picard declined to comment on the Magnify argument, saying that he would respond to it and the other pending objections in a formal answer to the court in January.

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