

1 UNITED STATES DISTRICT COURT  
2 DISTRICT OF NEW JERSEY  
3 CIVIL NO. 09-816-SRC-MAS

4 LAUTENBERG FOUNDATION, THE MOTIONS  
5 Plaintiff,  
6 VS.  
7 PETER MADOFF,  
8 Defendant.

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9 August 11, 2009  
10 Newark, New Jersey

11 B E F O R E: HONORABLE STANLEY R. CHESLER, USDJ  
12  
13

14 Pursuant to Section 753 Title 28 United States Code, the  
15 following transcript is certified to be an accurate record  
16 as taken stenographically in the above-entitled  
17 proceedings.

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1 THE COURT: Be seated. Good afternoon. Lautenberg  
2 Foundation vs. Madoff, 09-816. Please note your  
3 appearances for the record.

4 MR. RICCIO: Good morning -- good afternoon, your  
5 Honor. Ronald J. Riccio for the plaintiffs.

6 MR. GREENBERG: I'm Stephen Greenberg. I'm with  
7 Ronald Riccio.

8 MR. GRIFFINGER: Michael Griffinger, also with  
9 Riccio.

10 MR. MADERER: Good afternoon, your Honor. William  
11 Maderer of the Saiber firm on behalf of the defendant.

12 MR. SPADA: Your Honor, Charles Spada from Lankler,  
13 Siffert & Wohl. With me are my colleagues Joanne Harvey  
14 and Jeannie Rubin on behalf of defendant, Peter Madoff,  
15 also.

16 THE COURT: Good afternoon to you. All right. Mr.  
17 Spada, you're going to be arguing this for the defendants?

18 MR. SPADA: Yes, your Honor.

19 THE COURT: And Mr. Riccio, you're going to be  
20 arguing it for plaintiffs?

21 MR. RICCIO: Yes, your Honor.

22 THE COURT: All right. Mr. Spada, it's your motion.  
23 Why don't you start.

24 MR. SPADA: Thank you, your Honor. May it please  
25 the Court, my name is Charles Spada on behalf of the

1 defendant, Peter B. Madoff.

2 As your Honor is aware, we brought a motion to  
3 dismiss the complaint brought by the plaintiffs, which  
4 there are three plaintiffs here, The Lautenberg Foundation  
5 and two individual plaintiffs.

6 The complaint here alleges violations of the federal  
7 securities laws Section 10(b) and also 20(a), controlling  
8 personal liability, as well as various state law claims for  
9 breach of fiduciary duty, aiding and abetting a breach of  
10 fiduciary duty, negligent misrepresentation and negligence.

11 If it would please the Court, I will address first  
12 the federal securities law.

13 THE COURT: Fine. Why don't we focus on that to  
14 start off with.

15 MR. SPADA: Yes, your Honor. As your Honor is aware  
16 I'm sure from looking at the complaint, this case arises  
17 out of the Ponzi scheme committed by Bernard Madoff.  
18 There's no dispute as to that Mr. Madoff committed the  
19 scheme, that he's pled guilty, that he's in jail.  
20 Everybody's read all about that.

21 The scheme occurred at Madoff Securities, and I'll  
22 refer to the company as The Company or Madoff Securities.  
23 It's alleged that my client, Peter Madoff, who is Bernard  
24 Madoff's brother, worked at The Company and plaintiffs do  
25 not describe much of anything but allege that he was the

1 compliance officer, senior managing director, general  
2 counsel of Madoff Securities and that he worked with his  
3 brother there.

4 The plaintiffs do not allege many facts in their  
5 complaint with respect to the conduct of Peter Madoff.  
6 Plaintiffs allege his position, that he worked side-by-side  
7 with his brother, that he was highly skilled in the use of  
8 technology and the business operations of the company, and  
9 that he ignored various alleged red flags.

10 As the complaint is pled, it is pled as a  
11 misstatement or omissions case with respect to the 10(b)(5)  
12 claim, although plaintiffs in their brief claim that  
13 they're alleging scheme liability. It's clear if you look  
14 at the complaint, it doesn't allege that at all. It  
15 doesn't mention scheme liability with respect to the  
16 defendant at all.

17 It's clear what they're saying is that this is a  
18 misstatements and omissions case and that they allege that  
19 the defendant was responsible as a compliance officer,  
20 senior director, to ensure the accuracy of, and they point  
21 to essentially three statements; marketing materials, SEC  
22 filings of the financial condition of the firm, and monthly  
23 account statements that go to the investors.

24 Now, beyond that, they allege nothing as to the  
25 defendant's activity in connection with making any of these

1 statements and, as we point out in our brief, you know, the  
2 law is clear that you have to -- one of the first elements  
3 if you're making a misstatements or omissions claim, you  
4 have to allege and show that there's some misstatement that  
5 the defendant participated in making. It's not enough just  
6 to allege he's the compliance officer. There are false  
7 filings, false account statements, therefore, he is  
8 responsible for them.

9 The federal securities laws require more under  
10 10(b)(5) and, as your Honor is aware, the heightened  
11 pleading standards of 9(b) apply to the federal securities  
12 laws claims and you have to have some concrete allegations  
13 of what participation the defendant is alleged to have had  
14 with each of the particular statements that are claimed to  
15 be false. And here the complaint alleges nothing about was  
16 the defendant involved with the preparation of the  
17 financial statements. Although some marketing materials  
18 are referenced, it's not even alleged whether -- when those  
19 misstatements were made, whether the defendant had any  
20 participation with the creation or publication of those  
21 misstatements.

22 THE COURT: Let me stop you for just one second.

23 MR. SPADA: Yes, your Honor.

24 THE COURT: All right. In your brief, one of the  
25 first arguments you make is that they haven't even pled

1 that was in connection with the sale or offering or  
2 purchase or sale of a security, which of course is a basic  
3 requirement for any 10(b)(5) claim.

4 MR. SPADA: Correct, your Honor.

5 THE COURT: Now, the Supreme Court has given us sort  
6 of an expansive interpretation of what constitutes in  
7 connection with the sale of a security. Correct?

8 MR. SPADA: Yes, your Honor, that's correct.

9 THE COURT: If I recall correctly, SEC vs. Zanford,  
10 reported at 122 Supreme Court 1899 does, in fact, give an  
11 expansive view of what constitutes in connection with the  
12 sale or offer of a security.

13 MR. SPADA: That's correct, your Honor.

14 THE COURT: Are you seriously arguing that the  
15 complaint does not meet that, the requirement of the SEC  
16 standard at this point?

17 MR. SPADA: I'm saying that the complaint doesn't  
18 particularize what purchase or sale they're referring to  
19 and what the misstatement goes to, whether it was at the  
20 opening of the account, was it subsequent purchases or  
21 sales. It's not clear to me from the complaint how they're  
22 saying there's a nexus there. What is the purchase or  
23 sale?

24 I'm not saying that they couldn't allege it. I'm  
25 just saying that as drafted, you can't tell. But I agree

1 with your Honor that the Supreme Court precedent in other  
2 cases, that does take a very expansive definition of what  
3 is a security. I'm saying here there is no  
4 particularization of what they're saying as to what that  
5 security is.

6 THE COURT: As to what the nexus is.

7 MR. SPADA: That's correct, that's correct, your  
8 Honor. So, where here they're not alleging that the  
9 defendant signed, created any of the misrepresentations,  
10 he's not alleged to have prepared them, there's no  
11 allegation at all except for this general allegation that  
12 he is responsible for ensuring the accuracy.

13 We submit under the federal securities laws that is  
14 not enough for a misstatement or omissions case. All the  
15 cases in this area involve where somebody had some  
16 involvement with a misstatement or omission that can be  
17 pled. And there is a lack of facts in the complaint here  
18 alleging anything other than the defendant's position.

19 THE COURT: All right. Let me hear from them on that  
20 issue.

21 MR. SPADA: Sure.

22 THE COURT: All right. Mr. Riccio.

23 MR. RICCIO: Yes, your Honor.

24 THE COURT: First of all, is scheme liability pled in  
25 the complaint?



1 MR. RICCIO: Yes, it is, Judge.

2 THE COURT: Show me where.

3 MR. RICCIO: If you look at paragraph 39, we allege  
4 that Peter Madoff is a primary violator of Section 10(b) of  
5 the Exchange Act. We do not limit ourselves to A, B or C.  
6 Scheme liability is A and C.

7 THE COURT: Yeah.

8 MR. RICCIO: Misleading misrepresentations is B. We  
9 are alleging two things. We're alleging that the conduct  
10 of the defendant was manipulative and deceptive, and I can  
11 explain the details for that in a moment, and we're also  
12 alleging they're misleading misrepresentations.

13 Let me address, if I can, what I consider to be a  
14 fairly cramped reading of the complaint by the defendant.  
15 The suggestion is that we don't allege many facts and the  
16 suggestion is that perhaps the reasonable inferences that  
17 should be drawn from these facts should not be viewed in a  
18 light most favorable to the plaintiff, which is what the  
19 standard is even under Iqbal and the new approach to  
20 12(b)(6) motions.

21 But if I could, Judge, let me get into what the  
22 complaint does allege. First of all, I think you need to  
23 begin with the underlying fraud, which Mr. Spada correctly  
24 identifies as a Ponzi scheme. Everybody knows something  
25 about the Bernard Madoff scandal, but there's more to it

1 than just that. This Ponzi scheme lasted for 20 years.  
2 During that 20-year time period, the defendant was the  
3 chief compliance officer, senior managing director, general  
4 counsel, head of trading, and in a document filed with the  
5 SEC by BMIS, which Bernard Madoff testified in his plea  
6 allocution was prepared by him, identified Peter Madoff as  
7 a co-control person of BMIS.

8 THE COURT: Where is that pled?

9 MR. RICCIO: That's in Exhibit C to our complaint,  
10 page 20. If your Honor turns, your Honor, to page 20 of  
11 31, Exhibit C to our complaint, you'll see that there are  
12 some boxes, and beneath the name Bernard Madoff is the name  
13 Peter Madoff. Then it has title or status, director of  
14 trading, chief compliance officer. Date or title of status  
15 acquired, 1969. So, he held this position for 40 years.

16 And then under the label control person, the letter  
17 "Y" appears, indicating yes.

18 Then your Honor, if you look at paragraph 15 of our  
19 complaint, the allegations -- actually that would be  
20 paragraph 17 of our complaint -- the allegations very  
21 clearly spell out Peter Madoff's duties and  
22 responsibilities at BMIS as a control person and the senior  
23 managing director, director of trading, chief compliance  
24 officer, and general counsel of BMIS.

25 So, when Mr. Spada says that Peter Madoff worked at

1 BMIS, that might be the understatement of the century. He  
2 controlled BMIS with Bernard Madoff. He was the person who  
3 was responsible for ensuring, as we allege in our  
4 complaint, that BMIS adhered to the law.

5 For 20 years, while Peter Madoff worked side-by-side  
6 with his brother, there was a Ponzi scheme afoot which he  
7 did nothing about. The Ponzi scheme resulted in Bernard  
8 Madoff taking money from some investors, paying it out to  
9 other investors, filtering some of the money into the  
10 so-called legitimate arm of his enterprises, and keeping  
11 the rest of it for himself and his family and his friends.

12 In his plea allocution Bernard Madoff tells the Court  
13 how he perpetrated the fraud. He says I lied to the SEC, I  
14 lied to my clients, but then he also says things that are  
15 directly attributable to Peter Madoff.

16 THE COURT: Let me stop you again.

17 MR. RICCIO: Yes.

18 THE COURT: Where is this in the complaint?

19 MR. RICCIO: The plea allocution is attached as an  
20 exhibit to Mr. Spada's motion papers and it's appropriate  
21 to consider it, your Honor, as a public record. This came  
22 up in the In Re Able Labs case where matters outside the  
23 complaint can be considered if they're integral to an  
24 understanding of the complaint and if they're matters of  
25 public record, you can take judicial notice of the plea

1 allocation.

2 They submitted it to your Honor, so it's not --

3 THE COURT: I understand -- look, I know I can take  
4 and consider some things on a 12(b)(6) but, by and large,  
5 the factual allegations of a complaint are taken from the  
6 complaint. Correct?

7 MR. RICCIO: That is correct, your Honor. But they  
8 can be augmented when the complaint -- and this was an  
9 after-occurrence event from the filing of the complaint.  
10 But if your Honor doesn't want to take into account the  
11 plea allocation, that's fine.

12 THE COURT: It may be very well material which, in  
13 fact, could appropriately be submitted in connection with a  
14 repleading if that's appropriate but, in short, you know,  
15 and I've had some experience with taking into consideration  
16 matters outside of the complaint, but generally the Third  
17 Circuit law has been you look at matters outside the  
18 complaint which are essentially referred to or incorporated  
19 or relied upon by the complaint. You know, that's the  
20 basic rule in the Third Circuit, at least.

21 MR. RICCIO: Well, I'm referring to it, your Honor,  
22 because they presented it to your Honor in their papers.

23 THE COURT: And I thank you for doing that and I  
24 thank them for doing it, but I will tell you, all right, I  
25 mean, I've used material outside the complaint, as I've

1 said, where the complaint in fact relies upon that  
2 material. There have been situations and the Third Circuit  
3 has upheld looking at material outside the complaint for  
4 purposes of dealing with statute of limitations issues  
5 because the Court can take judicial notice of the fact  
6 that, for example, newspaper articles put people on notice  
7 of various things. But quite frankly, the mere fact that  
8 they have submitted or you submit a certification is not  
9 something which I am at least at this point inclined to be  
10 using in determining the sufficiency of the complaint --  
11 all right -- because, quite frankly, then I've got people  
12 changing the complaint in front of my eyes.

13 MR. RICCIO: We don't need to consider the plea  
14 allocution.

15 THE COURT: And then I get confused and, you know,  
16 Mr. Riccio, I'm very easily confused.

17 MR. RICCIO: Your Honor, you're not easily confused  
18 and if you are confused by the plea allocution, we don't  
19 need this --

20 THE COURT: Okay.

21 MR. RICCIO: -- to sustain this complaint.

22 THE COURT: Let's go back for a second. All right.  
23 I was asking you whether the complaint pleads scheme  
24 liability.

25 MR. RICCIO: Yes.

1           THE COURT: All right. And as I am reading the  
2 complaint, I've got his responsibilities laid out here,  
3 yes, and certainly the complaint alleges that Bernard  
4 Madoff admitted to a Ponzi scheme and, indeed, paragraph 28  
5 says the day before he confessed to the FBI, he told Peter  
6 Madoff and other BMIS employees that the investment  
7 advisory arm of BMIS was a fraud, that it was all just one  
8 big lie, and that they lost \$50 billion.

9           What I'm not seeing is how that pleads essentially  
10 his integral involvement in a scheme to defraud. As I  
11 recall the scheme liability theory, it is that the Supreme  
12 Court has asserted, number one, there need not be a  
13 misrepresentation or an omission where there's a duty to --  
14 an omission to disclose when there's a duty to disclose,  
15 conduct can be deceptive and that that is one of the  
16 hallmarks of scheme liability. And then we have all the  
17 case law which goes into great detail distinguishing  
18 between scheme liability and aider and abettor liability,  
19 and how one should not confuse one with the other, and then  
20 we really have the problem of figuring out where that line  
21 is supposed to be drawn.

22           But in the first instance I'm trying to see where  
23 this is really essentially asserting that Peter Madoff is  
24 part of this Ponzi scheme.

25           MR. RICCIO: Yes. Well, your Honor, what we need to

1 show is that he engaged in a deceptive act or a  
2 manipulative act.

3 THE COURT: Okay.

4 MR. RICCIO: In order to establish, from my pleading  
5 perspective, liability under 10(b)(5)(A) or (C) --

6 THE COURT: Right.

7 MR. RICCIO: -- we need only show that he, Peter  
8 Madoff, engaged in a deceptive act or a manipulative act.  
9 In paragraph 46 of our complaint we allege that he  
10 effectively covered up for years what his brother confessed  
11 was the largest financial fraud in history.

12 So, what did he do in covering up the largest  
13 financial fraud in history, and that takes you to what his  
14 function was at BMIS.

15 THE COURT: Paragraph 46 does that?

16 MR. RICCIO: Well, you know, your Honor, it's  
17 either -- we have two copies of the complaint. It's either  
18 46, right at the end of 46, the last sentence --

19 THE COURT: It says Peter Madoff confessed that he --  
20 confessed that he and BMIS violated the Securities Act of  
21 1934 and the regulations promulgated thereunder by  
22 intentionally engaging in a common plan, scheme, artifice  
23 to defraud and unlawful course of conduct, which he  
24 described as a giant Ponzi scheme that operated as a fraud  
25 and deceit upon plaintiffs in connection with the purchase

1 and sale of securities.

2 MR. RICCIO: Your Honor, then take a look at 38.

3 THE COURT: Maybe I am.

4 MR. RICCIO: 38 is what was attached to Mr. Spada's  
5 submission, paragraph 38. It's on page 16.

6 THE COURT: Okay. I've got it on page 15 of mine.  
7 All right.

8 MR. RICCIO: But the cover-up allegation is on page  
9 16.

10 THE COURT: Okay.

11 MR. RICCIO: We have the same complaint.

12 THE COURT: All right. Now, I think we've got it.  
13 Okay.

14 MR. RICCIO: Very good. Then you're working off of  
15 the exhibit to Mr. Spada's motion. I'm working off the  
16 same copy of the complaint. In any event, we've alleged  
17 the cover-up. Now, we don't just say in a conclusory  
18 manner that he engaged in a cover-up. We explain why this  
19 is our theory. Bearing in mind this is a motion to  
20 dismiss, we're not determining whether or not we're  
21 ultimately going to win this allegation but whether or not  
22 there's enough pled here.

23 What we have alleged is the following: There was a  
24 Ponzi scheme, which is admitted. It lasted for 20 years.  
25 It involved billions of dollars. Peter Madoff's function



1 was to work side-by-side with his brother for 20 years.  
2 His brother in an SEC filing identified Peter Madoff as a  
3 control person.

4 When you are a control person, you take  
5 responsibility for what's happening at the entity that  
6 you're controlling.

7 What was happening at the entity that Peter Madoff,  
8 along with Bernard Madoff, were controlling for 20 years  
9 was a vibrant, vicious, merciless Ponzi scheme. Who was  
10 in charged of complying with the law during that time  
11 period? Peter Madoff. Who was the general counsel? Peter  
12 Madoff. Who was the senior managing director? Peter  
13 Madoff. Who was in control of the management and policies  
14 of the business at the time the Ponzi scheme was being  
15 perpetrated according to Bernard Madoff? Peter Madoff.

16 Did he just say that arbitrarily? No. He put in it  
17 a sworn filing with the SEC, which, while Mr. Bernard  
18 Madoff admitted a lot of lying and a lot of fraud and a lot  
19 of deceit, the one thing he never said was that the  
20 statement in the SEC form describing his brother as a  
21 control person was not true and correct.

22 Now, given all of his functions, who's responsible  
23 for sending out the monthly statements? Who's responsible  
24 for the confirms? Who's responsible for the SEC filings?  
25 Who's responsible for the financial statements? All of

1 that is the responsibility we allege of Peter Madoff, not  
2 because he's Bernard Madoff's brother but because he has  
3 all of these functions.

4 When you have these functions and consciously avoid  
5 doing them and recklessly disregard looking into the facts,  
6 when you ignore the obvious, when you turn your back on  
7 crimes that are being committed under your nose, not for a  
8 week but for 20 years, we allege that's deceptive,  
9 manipulative actions. We allege that violates subsections  
10 (A) and (B) of 10(b)(5).

11 So, this again, your Honor, we haven't had any  
12 discovery. We tried to take his deposition on an emergency  
13 basis. We did not succeed in getting his deposition. He  
14 has not submitted a word -- not that it's his obligation to  
15 do so on a motion to dismiss -- but there's nothing from  
16 Peter Madoff saying I wasn't a control person, I wasn't the  
17 senior managing director, I'm not responsible for the  
18 fraudulent monthly statements and confirms.

19 By the way, monthly statements and confirms are  
20 generated by technology. We allege in our complaint that  
21 the technological genius behind BMIS was Peter Madoff.  
22 We're not talking about an occasional confirmation  
23 statement or monthly statement. We're talking about over a  
24 period of 20 years thousands of confirmation and monthly  
25 statements.

1           Not one of those thousands of transactions ever  
2 happened, and who's the cop on the beat while these  
3 technologically-generated confirms and monthly statements  
4 are going to customers? Peter Madoff. This conscious  
5 avoidance of the obvious, reckless disregard to look into  
6 how the business is going on, how could a compliance  
7 officer even on a random sampling conclude that everything  
8 was okay when not one customer, according to the confirms  
9 and the monthly statements, lost a penny? Statistically  
10 impossible.

11           We say that's evidence of deceptive, manipulative  
12 acts within the meaning of 10(b)(5)(A) and (C).

13           In addition, you have the red flags that we allege in  
14 some detail in the complaint which are ignored by Peter  
15 Madoff, and what do these red flags show? These are not  
16 casual matters that might require your Honor or I to look  
17 into or not look into. These are some glaring problems  
18 that are front and center for 20 years which the co-control  
19 person of BMIS did nothing about.

20           The 17th floor of the lipstick building where the  
21 Ponzi scheme was operated was off limits to people at BMIS.  
22 If you're the head of compliance, Judge, or the general  
23 counsel or a control person, wouldn't you want to know why  
24 the 17th floor was called the cage and nobody was allowed  
25 there? Wouldn't you want, maybe after the first or second

1 year, to look into that?

2 In addition, the returns, as I mentioned, the returns  
3 on the monthly statements, nobody ever lost money.  
4 Everybody, whether the market is up or down, everybody is  
5 making money. If you're the head of compliance, you can't  
6 just turn your back on it. That's the point.

7 THE COURT: Let me ask you a question.

8 MR. RICCIO: Yeah.

9 THE COURT: If you bought into Berkshire Hathaway in  
10 1960 and you kept it until 1990, I don't know when  
11 Berkshire -- all right -- but let's say you kept it for 30  
12 years, did Berkshire Hathaway ever lose money?

13 MR. RICCIO: Every single month? I don't know what  
14 Berkshire Hathaway's --

15 MR. GREENBERG: They lost money last year, your  
16 Honor.

17 THE COURT: Last year? Before that, Mr. Greenberg.

18 MR. GREENBERG: I don't know, but that's -- they were  
19 investing in privately held companies. They were totally  
20 transparent.

21 Here, your Honor, as the dean is pointing out, year  
22 in, year out, if Bernard Madoff met Judge Chesler, he'd  
23 say, hmm, Judge Chesler, he needs 11 percent. Every year  
24 Judge Chesler gets 11 percent. He meets Dean Riccio. Hmm,  
25 Dean Riccio, he needs 14 percent. Every year he gets 14

1 percent. With all due respect, that's not Warren Buffett,  
2 your Honor.

3 MR. RICCIO: And your Honor, if I might, we're not  
4 talking about year-end performance. We're talking about  
5 every single month.

6 Here's another fact that was ignored. No outside  
7 brokers were ever used by BMIS. In order for BMIS to  
8 operate its Ponzi scheme, the monthly statements that went  
9 out needed to show trades, buys and sells. BMIS used no  
10 outside brokers and they did not use the so-called  
11 proprietary arm of BMIS to execute trades.

12 Well, if you're the compliance officer, wouldn't you  
13 say to your brother, gee, Bernie, I see you're doing a lot  
14 of trades here from the account statements that are going  
15 out. Who's executing the trades? Answer, nobody.

16 Wouldn't Peter say to Bernie, well, somebody's got to  
17 be doing it. We're not doing it. What outside broker are  
18 you using? Answer, none.

19 Of course we know now why there were no brokers  
20 executing the trades, because there were no trades. But  
21 for 20 years you're asleep at the switch? You don't ask a  
22 question? You turn your back? You don't get your brother  
23 alone and say what's going on here?

24 THE COURT: All right. Let me stop you for a second.  
25 Let me hear what their response is to that.

1           MR. SPADA:     Thank you, your Honor.  I do think we  
2     need the deposition of Mr. Buffett in this case to find  
3     this out but, your Honor, I think plaintiff has conflated a  
4     bunch of issues in the argument that was just made.  I  
5     think the issues of scheme liability and misstatement,  
6     omission have been conflated, as well as the issue of  
7     control person, that designation and that form of  
8     liability.

9           THE COURT:    Okay.  But let's take the basic argument  
10    which I've heard -- all right -- which is essentially Peter  
11    Madoff, who's there for 20, 30 years, whatever it is, the  
12    complaint does say that he held specific positions, which  
13    included general counsel, which included chief of  
14    compliance.  He was named as a control person, let's see,  
15    director of trading, senior managing director.  All right.  
16    If I recall correctly, those are the positions which are  
17    held.

18          MR. SPADA:     Yes, your Honor.

19          THE COURT:    Now, you have correctly pointed out in  
20    your papers that saying that someone holds a position does  
21    not in and of itself demonstrate culpable participation,  
22    etc., or responsibility.  Right?

23          MR. SPADA:     Correct, your Honor.

24          THE COURT:    Okay.  In paragraph 15 of the complaint,  
25    however, and I hope that we're all on the same page with

1 the complaint, what's asserted is that his duties and  
2 responsibilities in these positions included directing the  
3 management and policies of BMIS, regularly verifying and  
4 accurately reporting the financial condition of BMIS,  
5 establishing, implementing, controlling, monitoring and  
6 enforcing a compliance program of internal controls  
7 designed to ensure BMIS's compliance with all laws, the  
8 detection, prevention and reporting of all violations of  
9 any laws or regulations by BMIS or its employees. And  
10 then it explains his varied experience.

11 Now, does that recitation of the duties that he has  
12 cure any of the problems which you see with the complaint?

13 MR. SPADA: No, your Honor, because --

14 THE COURT: Why not?

15 MR. SPADA: -- our position is that portion of  
16 paragraph 15, those are legal conclusions, and as the  
17 Supreme Court has said in Iqbal and the judge has recently  
18 cited in one of his opinions, you essentially take those  
19 legal conclusions for purposes of assessing the sufficiency  
20 of the complaint and you can't rely on them. You have to  
21 look at well-pleaded factual allegations.

22 These are legal conclusions drawn, as far as I could  
23 tell, made up just from what they think the title means  
24 should be his responsibilities. These are not well-pled  
25 factual allegations. They're purely legal conclusions and

1 they deserve no weight for purposes of assessing the merits  
2 of the securities law claim.

3 THE COURT: Now, if they weren't legal conclusions,  
4 in fact they described what I set forth have been the job  
5 responsibilities of Peter Madoff in some filings or  
6 documentation, would that be different?

7 MR. SPADA: I don't believe so, your Honor, because  
8 it still doesn't talk about an affirmative. It talks about  
9 sort of a policing role, enforcing role. It's still, for  
10 purposes of whether he was involved in the misstatement or  
11 omissions being made, it still says nothing as to what he's  
12 actually doing with respect to the creation of those  
13 misstatements or omissions.

14 It might be saying he had these responsibilities and  
15 he didn't do them, but the securities laws, 10(b)(5), the  
16 case law I think demands more.

17 THE COURT: And what does it demand?

18 MR. SPADA: I think here where, as we're saying, if  
19 you look at the complaint carefully, they do not allege  
20 scheme liability. They allege misstatement and omission  
21 liability. The case law talks about that for the  
22 misstatements, they have to have been involved in the  
23 making of them. The case law says were they a signer?  
24 Were they involved in the preparation? Were they involved  
25 in sending the monthly reports out and such?



1           A mere compliance role where you're maybe responsible  
2 for looking at something, I don't think under the 10(b)(5)  
3 case law under a misstatement or omission case standing  
4 alone is enough. It's not enough participation.

5           THE COURT: Let's ask Mr. Riccio about that. First,  
6 what misstatements is Peter Madoff alleged to have made?

7           MR. RICCIO: The misstatements he's alleged to have  
8 made pertain to the sales brochure which is exhibit, I  
9 think it's A-1 or A-2, in which they talk about BMIS being  
10 a highly ethical business. Quality has been our hallmark.  
11 The owner's name is on the door. You can count on us to  
12 treat you correctly.

13           That's a misstatement. He's, as a control person,  
14 he's responsible for that under the law as a control  
15 person. This is not a legal --

16           THE COURT: Let's do 10(b)(5). All right.

17           MR. RICCIO: In addition, we have the monthly  
18 statements.

19           THE COURT: Okay. Wait a second. What is there in  
20 the complaint which says that he said that, that he said  
21 what is in --

22           MR. RICCIO: He didn't say it but he is responsible  
23 for the entity that promulgates the document. Plus, your  
24 Honor, we don't have everything that got filed with the  
25 SEC. I fully expect to see his name appear on audit forms

1 that you have to file with the SEC, on financial statements  
2 and things of the like.

3 We don't need to show that he signed it. We don't  
4 need to show that it came out of his mouth under  
5 10(b)(5)(A) and (C).

6 THE COURT: No. But I'm not talking about (A) and  
7 (C). All right. Right now I'm talking about --

8 MR. RICCIO: (B).

9 THE COURT: -- I'm talking about (B). Under (B), I  
10 want to know affirmative misrepresentations or omissions  
11 where there's duty to speak.

12 MR. RICCIO: All right. Then your Honor, on that, if  
13 I could, I would refer you for starters, paragraph 38 of  
14 the complaint in which we describe not the scheme and not  
15 the deceptive acts, but we describe what are the statements  
16 that we say are attributable to him. The statements  
17 pertain to the sales literature. It's the monthly  
18 statements, it's the confirms, the financial statements,  
19 the SEC filings. These are all false. We know they're  
20 false statements. There's no issue about materiality, no  
21 issue about falsity. The only issue is who gets blamed for  
22 lying.

23 THE COURT: Okay. Now, this is paragraph 38, the  
24 paragraph starts off notwithstanding the --

25 MR. RICCIO: Yes, yes.

1           THE COURT: And in it what you do is you say he  
2           recklessly ignored and/or controlled and/or failed to  
3           disclose and/or consciously disregarded.

4           MR. RICCIO: And later on we say recklessly made and/  
5           or acquiesced in the making of, he made or acquiesced in  
6           the making of. Your Honor, at the end of the day is  
7           Bernard Madoff the only person to be responsible for lying  
8           when the entity that is controlled by him and his brother  
9           is filing false statements all over the place to which  
10          Bernard Madoff pled guilty, to which he's serving 150 years  
11          in jail? I think not. I think there's got to be joint  
12          responsibility here when there's two people that are  
13          identified unmistakably, undisputedly as in control of the  
14          entity that's lying to the SEC, that's lying to customers.

15          THE COURT: Okay. And Mr. Riccio, don't I have to  
16          have a complaint which complies with specificity  
17          requirements as the Supreme Court has now interpreted Rule  
18          8 and with the PSLRA?

19          MR. RICCIO: Your Honor, we don't dispute that  
20          there's got to be more specificity required when you're  
21          pleading a claim under 10(b)(5), not under control person,  
22          but under 10(b)(5).

23          THE COURT: Right now we're talking about 10(b)(5).

24          MR. RICCIO: And I would say to your Honor I don't  
25          know what more specificity you can put into a complaint

1 than the document in which the lie appears, namely, the  
2 sales literature, than the identification of the documents  
3 where the lies occurred, the financial statements, than his  
4 role as control person in a document that's sworn to and  
5 filed with the SEC.

6 I mean, I think the only question for your Honor is  
7 does Peter Madoff have no responsibility for lying to the  
8 government and customers because he's not the entity, he's  
9 only a co-control person.

10 To state the question is to answer it. If you are a  
11 co-control person of an entity that lies to your customers  
12 and lies to the government and files false financial  
13 statements, if that doesn't satisfy Rule 9(b), nothing  
14 does. Impossible to satisfy it short of starting a lawsuit  
15 and taking depositions and then coming back and amending  
16 the complaint, which is not what 9(b) requires. They  
17 require specificity so that they can know what it is we're  
18 saying.

19 Is there any doubt that they know what we're accusing  
20 Peter Madoff of? Is there any doubt? Are they saying what  
21 documents did he lie in? Of course not. It's in the  
22 complaint. Are they saying we don't know how he lied? We  
23 say how he lied. Bernard Madoff tells you how he lies.

24 So, the only question for your Honor is does Bernard  
25 (sic) Madoff get a pass because he's a human being who

1 controlled an entity that filed the documents, and I don't  
2 think he can hide behind -- Peter Madoff can't hide behind  
3 the entity and he can't hide behind his brother. He's got  
4 to stand up for what he is and was at BMIS, control person,  
5 chief compliance officer, senior managing director, general  
6 counsel, director of trading. What more responsibility can  
7 a person have. To say that he worked at BMIS, as I said at  
8 the outset, is the understatement of the century. He  
9 controlled the entity.

10 THE COURT: How, apart from the titles and the filing  
11 as a control person, what pleads -- what pleads facts which  
12 say that -- let me ask you this. All right. From this,  
13 what I'd like to know is what do I have which does not --  
14 which demonstrates, for example, that Bernard Madoff  
15 concluded that Peter Madoff is his dumber younger brother  
16 and we're going to give him some titles and stick him in an  
17 office?

18 MR. RICCIO: For you to conclude that he's the dumber  
19 younger brother, your Honor, given the person's record in  
20 the industry, he's a lawyer. He's been in the business for  
21 40 years and he's pleaded to be the technology expert is a  
22 beginning premise that is flawed.

23 He's a highly intelligent, very skilled, very  
24 experienced, very talented individual who had functions  
25 that he ignored. And if you read paragraph 15 in

1 conjunction with paragraph 38, and you read what we've  
2 alleged his functions are, and when you read what we know  
3 is false, the nexus is obvious. He was the person who was  
4 there on the job when these false statements were filed.  
5 He was the person there.

6 If you were to say as between Bernard Madoff and  
7 Peter Madoff who had responsibility for those statements,  
8 it would be Peter Madoff. Bernard Madoff wasn't head of  
9 compliance. He wasn't senior managing director. He wasn't  
10 a general counsel, director of trading. He was none of  
11 those things, so, why he is getting all the blame for this  
12 and Peter has the potential for a pass because the entity  
13 might have filed the form that he didn't sign. That's not  
14 the law. That's not the law of control person.

15 When you are in control of an entity, you are  
16 responsible for management and policies. Management and  
17 policies is the whole kit and caboodle for the entity.

18 THE COURT: Are you arguing that I should throw out  
19 the 10(b)(5) and I should simply maintain the Section 20  
20 claim?

21 MR. RICCIO: No. What I'm saying is these claims are  
22 pled in the alternative. We have a 20(a) claim which we  
23 haven't talked about yet.

24 THE COURT: But you've been arguing Section 20.

25 MR. RICCIO: No.

1 THE COURT: You've been arguing control person.

2 MR. RICCIO: No. What I'm -- no, your Honor. Under  
3 control person you can be a control person without  
4 performing all of the functions that Peter Madoff performed  
5 here. What we're saying under 10(b)(5) is that his control  
6 person status, combined with the other functions that he  
7 performed, hold him accountable at the pleading stage as a  
8 primary violator.

9 THE COURT: And their argument is that your  
10 description of his responsibilities is purely legal  
11 conclusion.

12 MR. RICCIO: Your Honor, it is not a legal conclusion  
13 to describe his functions. I think your Honor's -- he  
14 directed the management and policies of BMIS. That's not a  
15 legal conclusion. He was responsible for verifying the  
16 financial condition. That's not a legal conclusion. He  
17 was responsible for internal controls. That's not a legal  
18 conclusion. Detection, prevention and reporting of all  
19 violations of any laws or regulations, that's not a legal  
20 conclusion. Those are all facts. We've alleged those  
21 facts.

22 If he wanted to, he could have come forward and said  
23 something in response, but we're dealing with the facts in  
24 this complaint and with the responsibility to allege them  
25 with particularity under 10(b)(5), which I think we've done

1 in paragraph 38, but also, your Honor, under Iqbal, Iqbal  
2 talks about plausibility on its face and talks about your  
3 Honor using your judicial experience and common sense in  
4 deciding whether the complaint goes forward.

5 I think that tells the whole story here. What does  
6 your Honor's common sense tell you about this complaint?  
7 Does your Honor's common sense tell you that at the  
8 pleading stage, Peter Madoff should be cut loose because  
9 there isn't enough here or does your common sense tell you  
10 there's something here, it's pled with a degree of  
11 specificity?

12 Considering it's a fraud case and it's hard to learn  
13 all the facts about a fraud from the defendant before the  
14 depositions start, does your common sense tell you in a  
15 case like that the complaint goes forward? If it goes  
16 forward and if we cannot substantiate these claims, then  
17 there's always summary judgment or even a voluntary  
18 dismissal for that matter, but at this juncture, given what  
19 we have to work with, give what we know the undisputed  
20 facts are, I can't imagine what more would be required by  
21 way of particularity to hold Peter Madoff accountable in  
22 the exact same way, perhaps even more so, than his brother  
23 Bernard under 10(b)(5), because Bernard, while he may have  
24 pleaded guilty, the reality is that the person running the  
25 day-to-day operation of the Ponzi scheme was Peter Madoff.



1 That's our allegation, unrefuted.

2 THE COURT: Well, I've got to tell you, I'm not  
3 seeing that from this complaint, that Peter Madoff is  
4 accused of running the day-to-day operations of the Ponzi  
5 scheme.

6 MR. RICCIO: Running the day-to-day operations of the  
7 Ponzi scheme in the sense that the confirmation statements  
8 are going out without any inquiry into the validity, the  
9 monthly statements are going out, the financial statements  
10 are going out. He's facilitating it. Perhaps the word  
11 running is an overstatement. He's facilitating it. He's  
12 allowing it to happen by a conscious avoidance of the  
13 obvious.

14 THE COURT: So, all right. Now I've gotten down to  
15 what is essentially you're arguing conscious avoidance.

16 MR. RICCIO: From a scienter standpoint we're arguing  
17 that his failure to monitor, which is what the cases say  
18 under the Infinity case, Judge McKee's Infinity case, the  
19 failure to monitor even in the belief that what was going  
20 on was honest is not a good enough defense.

21 Even a neophyte, Judge McKee in Infinity says, even a  
22 neophyte looking at this situation, looking at what was  
23 going on for 20 years should know that something was amiss  
24 at BMIS.

25 Peter Madoff found nothing amiss at BMIS. We say

1 that constitutes a violation under 10(b)(5)(A) and (C), and  
2 (B), the statements consist of the items that I identified  
3 for your Honor. That's our position.

4 THE COURT: All right. So, the PSLRA demonstration  
5 of scienter you're relying upon is essentially that same  
6 thing plus the flags. I got it.

7 MR. RICCIO: For the scienter?

8 THE COURT: Yes.

9 MR. RICCIO: We are alleging for scienter, your  
10 Honor, well, much more than that, if I could. I don't know  
11 if your Honor wants me to go through it but I can.

12 THE COURT: Yeah.

13 MR. RICCIO: Certainly the existence of the  
14 underlying fraud, the length of it and the magnitude of it.  
15 I think, Judge, you have to look at this and, in fact,  
16 Iqbal says this, you have to look at the complaint in a  
17 context. So, I've got to put in it a context to understand  
18 where we are coming from at this juncture without there  
19 having been any discovery.

20 You have the underlying fraud. You have the various  
21 functions that we allege in detail in paragraph 15. You  
22 have his technological expertise. You have the fact that  
23 we allege he worked side-by-side with his brother for 40  
24 years, 20 of which were the Ponzi scheme. We have the  
25 sales literature which we've already talked about. We have

1 the ADV form in which Peter Madoff is identified as the  
2 control person, which I think is the most important  
3 document in the case at this juncture. And what you then  
4 have is the cover-up, Peter Madoff cover-up. How does he  
5 cover it up? He covers it up, and this is where conscious  
6 avoidance, reckless disregard of the obvious, whatever,  
7 knowing indifference, what I describe it as the cop turning  
8 his back on a crime occurring in his presence and  
9 pretending it's not happening. This is what Peter Madoff  
10 did.

11 Compliance controls, nonexistent. Enforcement of  
12 compliance if there were any, none. How could he allow the  
13 17th floor to be off limits to people for 20 years? How  
14 could he allow the 17th floor to generate trades when there  
15 was no broker executing the trades? How could this be?  
16 How could any person, reasonably thinking person who has  
17 those functions ignore those obvious facts; the filings  
18 with the SEC, the false financial statements.

19 But then look at the red flags. He's got an  
20 accountant doing the books of BMIS who operates out of a  
21 strip mall. He's now under indictment but at the time we  
22 allege the complaint, it was a two-person accounting firm  
23 auditing a billion dollar business and you're the control  
24 person of that entity, you're the compliance officer,  
25 general counsel, head of trading, and you have a strip mall

1 accountant now under indictment auditing your books?  
2 That's the definition of conscious avoidance, if not actual  
3 knowledge that something is amiss.

4 You want to have an accountant who's compliant, who  
5 will do whatever you say or doesn't know the difference  
6 between right and wrong.

7 In addition, you have the Markopolos correspondence.  
8 This is the person, your Honor may have heard his name  
9 before, this is the person who in 1999 and again in 2005  
10 identified in detail the BMIS Ponzi scheme.

11 Well, if, your Honor, you're a control person of an  
12 entity and somebody twice sends a 40-page missive to the  
13 SEC explaining why your business enterprise is a Ponzi  
14 scheme, wouldn't you do something to stop it or to find out  
15 about it? Nothing. That gets ignored.

16 And then again, the trading patterns, the success all  
17 the time. We also have the commingling of funds. Bernard  
18 Madoff testified and, your Honor, this was in his plea  
19 allocution so if you don't want to hear it, I'll push it --

20 THE COURT: I don't want to hear it.

21 MR. RICCIO: -- I'll push it to the side. But in any  
22 event, Judge, those are the factors that we believe show --  
23 they certainly show a 20(a) valid cause of action as well  
24 as the state common law claims.

25 All we're debating at the moment is 10(b)(5). These

1 are the allegations on which we base 10(b)(5). The  
2 scienter requirement does not need to be an actual intent  
3 to deceive. It can be a reckless disregard. Judge McKee  
4 pointed that out in Infinity. And when these two guys who  
5 claimed we thought everything was on the up-and-up, Judge  
6 McKee said your good faith in thinking everything was on  
7 the up-and-up isn't the answer. You have scienter because  
8 you recklessly disregarded knowing the truth, and if you  
9 recklessly disregard knowing the truth at least at the  
10 pleading stage, you have scienter under 10(b)(5). That's  
11 the Infinity case.

12 In Re Able Labs says the same exact thing. People  
13 who have compliance functions, when the company is  
14 violating the law and do nothing to stop it, cannot avoid  
15 liability under 10(b)(5) by simply saying I didn't know, I  
16 thought everything was on the up-and-up. The answer is you  
17 should have known. You should have known everything was on  
18 the up-and-up, and if you did what your job required you to  
19 do, in even a modicum of carefulness, this Ponzi scheme  
20 would have stopped 20 years ago. It wouldn't have got more  
21 than a week into operation if Peter Madoff did what he was  
22 supposed to do.

23 THE COURT: Let's hear from Mr. Spada. Why is he  
24 wrong?

25 MR. SPADA: As your Honor correctly pointed out, the

1 conscious avoidance or the regular flags argument goes to  
2 scienter. It does not go to the issue we were talking  
3 about before, which is can this defendant have been said to  
4 made or had a duty to speak with regard to the omissions or  
5 is scheme liability pled.

6 We submit they failed on both those accounts. The  
7 Court doesn't even need to reach scienter. However, I will  
8 address the scienter argument. First off, plaintiff's  
9 counsel pointed to this 40-page missive by Markopolos to  
10 the SEC.

11 There's no allegation that the defendant saw what was  
12 sent to the SEC or was made aware of it. The complaint  
13 makes no allegation of that at all. Moreover, as the Court  
14 is probably aware, that the conduct has to be so highly  
15 unreasonable or an extreme departure from the standards of  
16 ordinary care.

17 In a recent case involving the Bayou Hedge Fund,  
18 which was also a Ponzi scheme, the court found that  
19 purported red flags that were reported publicly or to a  
20 regulatory agency and where you're saying they were alerted  
21 to the fraud by then but the SEC didn't act or the IRS  
22 didn't act, it doesn't rise to the level of creating  
23 sufficient scienter.

24 Here even, the red flags they're pointing to,  
25 investors were aware of, so to say that it's an extreme

1 departure from the standards of ordinary care where the SEC  
2 is alerted to them, the red flags they're talking about are  
3 obvious and open to the public, that they don't rise to the  
4 level under the securities laws of an extreme departure  
5 from the standards of ordinary care and, as I said, they do  
6 not even allege in this complaint that this supposed  
7 Markopolos complaint to the SEC, that the defendant was  
8 ever made aware of this, so, as pled, they certainly don't  
9 plead enough as to that, your Honor, and so, we don't think  
10 scienter is met. We don't even think you need to get to  
11 that issue, however.

12 THE COURT: Assuming that the complaint properly  
13 pleads not as conclusory language but properly pleads his  
14 duties with regard to BMIS, wouldn't a two-person  
15 accounting firm be something which would be raising your  
16 hackles a little bit for a multi-billion dollar fund?

17 MR. SPADA: I don't believe that the complaint  
18 pleads that the defendant was responsible for the audit of  
19 the fund.

20 THE COURT: It does plead he's responsible for  
21 compliance, however. Right?

22 MR. SPADA: Yes.

23 THE COURT: And verifying and accurately reporting  
24 the financial condition of BMIS. Correct?

25 MR. SPADA: Correct.

1 THE COURT: Okay. I mean, if I am -- I see Dean  
2 Riccio being very vigorous in his argument or whatever and  
3 is certainly dramatic, but if I cut through some of the  
4 dramatics and at least focus on his common sense argument,  
5 which is does common sense at least sort of stop at the  
6 door of a two-person accounting firm doing certified --  
7 doing audits of this kind of operation?

8 MR. SPADA: Your Honor, I don't know that that rises  
9 to the level of being highly unreasonable, especially where  
10 there are sparse allegations with respect to the defendant  
11 having any responsibility for the auditing of the fund.

12 THE COURT: Well, and their argument to a certain  
13 degree is that, yeah, the only people who knew about this  
14 are the people who are inside. I mean, to a certain degree  
15 and, I mean, there is no doubt that Iqbal does indeed  
16 require specific pleading.

17 MR. SPADA: Correct.

18 THE COURT: All right. In context.

19 MR. SPADA: Correct, your Honor.

20 THE COURT: But in some ways this is not my typical  
21 10(b)(5), is it?

22 MR. SPADA: That's correct.

23 THE COURT: My typical 10(b)(5) ends up with  
24 misrepresentations about cash flow, about, let's see, what  
25 are the last few I've had --



1 MR. SPADA: Loading.

2 THE COURT: -- cash flow, the medical profile of a  
3 pharmaceutical, channel stuffing allegations, so on and so  
4 forth.

5 MR. SPADA: Correct, your Honor.

6 THE COURT: Here it is a very different fish, isn't  
7 it? It is Mr. Bernard Madoff's black box.

8 Question, is Iqbal going to in fact be a bar to  
9 pleading where what's been occurring is indeed to be  
10 extraordinarily different for anyone to get full specifics  
11 about?

12 MR. SPADA: Full specifics at this stage, your  
13 Honor, for purposes of pleading it?

14 THE COURT: Yeah. Let me put it this way. All  
15 right. I'm sure you folks on both sides, before you have  
16 argument before a judge, run Lexis and Westlaw and run  
17 every darn opinion that is ever issued, so, I'm sure you're  
18 not in the least bit unaware of the fact that I've got a  
19 securities fraud case which is going up to the Supreme  
20 Court on statute of limitations.

21 Question, as the plaintiffs start walking an  
22 incredibly fine line between having sufficient information  
23 to be able to plead in a manner to satisfy both the PSLRA  
24 and Iqbal and, on the other hand, waiting too long and  
25 being told by a district judge that you are on inquiry

1 notice two years before you filed the complaint and that  
2 you've blown the statute of limitations.

3 MR. SPADA: Respectfully, your Honor, and I  
4 understand the dilemma your Honor is talking about, I don't  
5 think that's present here or what accounts for the lack of  
6 specificity in the complaint.

7 THE COURT: Then what do you think accounts for the  
8 lack of specificity in the complaint?

9 MR. SPADA: I believe what it accounts for, as your  
10 Honor is aware and given the nature as your Honor points  
11 out, this is a very unique, highly publicized biggest Ponzi  
12 scheme ever. The U.S. Attorney's Office is actively  
13 investigating it and gathering the facts.

14 There is a SIPC trustee that is actively  
15 investigating it and gathering the facts. They're in  
16 possession of all the records. They've been talking to and  
17 have access to the witnesses that are available. These  
18 plaintiffs wanted to get out in front for fear that either  
19 the U.S. Attorney's Office or the SIPC trustee will, in  
20 gathering and have facts, potentially be able to bring  
21 claims where they won't be able to recover in this court  
22 for their own behalf but, rather, assets will be gathered  
23 for the benefit of all investors, so, I submit that's the  
24 rush that's going on here. That's why there are no facts  
25 in the complaint and they're just legal conclusions being

1       pled.

2               THE COURT:   Doesn't that usually get resolved by  
3 applications before the panel on multi-district litigation  
4 to consolidate proceedings when push comes to shove?

5               MR. SPADA:    It may, although when you're dealing  
6 with a SIPC trustee, you might not be dealing with  
7 consolidation.  The SIPC trustee is going to be arguing  
8 that they usurp the claim and essentially they have the  
9 rights to the assets for the distribution to all creditors  
10 and individual plaintiffs can't come in and make a claim  
11 just for themselves.

12              THE COURT:   Well, then, that will resolve the whole  
13 problem if they assert that, won't it?

14              MR. SPADA:    For them maybe.  But I think that is why  
15 we see a complaint that was rushed to be filed with no  
16 facts and only legal conclusions.  And I don't think, you  
17 know, that it was filed because there is some danger of a  
18 statute of limitations running.

19              THE COURT:   But there is, in fact, a set of  
20 conflicting prerogatives or issues, is there not?

21              MR. SPADA:    That's correct, your Honor.

22              THE COURT:   Let's go to Section 20.

23              MR. SPADA:    Sure.  As your Honor is aware, we've  
24 also moved to dismiss the Section 20 claim.

25              THE COURT:   Right.  And apparently, the bulk of my

1 colleagues in New Jersey conclude that pleading culpable  
2 involvement is not a pleading requirement but is merely a  
3 proof requirement. Apparently, the bulk of the judges in  
4 the Southern District of New York have held to the contrary  
5 and there appear to be outliers in both districts which  
6 have gone the other way. Your position obviously is that  
7 culpable participation is required to be pled.

8 MR. SPADA: Yes, your Honor, and I know your Honor  
9 has not ruled in a case --

10 THE COURT: I have been totally out of that issue,  
11 yes.

12 MR. SPADA: So, I apologize to bring this mess now  
13 to your doorstep. We both agree that the Third Circuit has  
14 said that culpable participation is an element that's  
15 required under 20(a). The Third Circuit has found that.  
16 There's some difference of opinion out there but that's  
17 been made clear in the Third Circuit. It is an element of  
18 20(a) and the plaintiffs concede that in their brief.

19 The question is, does it need to be pled in the  
20 complaint, and I've read the cases. Quite honestly, your  
21 Honor, I don't understand the argument. If something is an  
22 element, I think that answers it, it needs to be pled. And  
23 the statute itself, in talking about controlling person  
24 liability, talks about that the defendant must have been  
25 alleged to directly or indirectly induce the act or the

1 acts. It's not mere nonfeasance. It requires an  
2 inducement and a participation.

3 And so, I think it's clear, if, as the Third Circuit  
4 says, it is an element, you have to plead your elements,  
5 and the language of the statute is clear. You need to  
6 plead an act of inducement, a participation in the  
7 underlying fraud. So, here again, there is a fatal flaw in  
8 that there is no inducing act being pled and, so, I  
9 understand that certain of your colleagues have found that  
10 at this stage you don't need to plead it but I would submit  
11 that the Judge Lechner decision in In Re Nice Systems and  
12 also the Southern District cases we cite to make more  
13 sense. If you're saying it is an element, you have to  
14 plead it. They're not -- the Third Circuit is not saying  
15 it's not plaintiff's burden.

16 THE COURT: And if it is an element, have they pled  
17 it?

18 MR. SPADA: No, your Honor.

19 THE COURT: Their argument would be that the  
20 pleadings which they've done in connection with the  
21 10(b)(5) are -- those factual allegations would be more  
22 than sufficient to plead culpable participation.

23 MR. SPADA: And we don't believe they are, your  
24 Honor, and that goes to a second layer of confusion in the  
25 courts which is, does the 9(b) heightened pleading standard

1 apply to 20(a) or is it just the (A)(B) pleading standard,  
2 and I would submit, and I think the cases follow this, if  
3 you agree that culpable participation is an element, and  
4 the Third Circuit does, if you agree that culpable  
5 participation needs to be pled up front, then I think you  
6 really have to conclude that the 9(b) heightened pleading  
7 standard applies to that.

8 I would submit it only makes sense to apply the  
9 federal Rule 8 standard if you're saying it doesn't need to  
10 be pled. And if you're talking about pleading culpable  
11 participation under a 9(b) pleading standard, again, the  
12 same issues we were talking about before, I think it's a  
13 fatal flaw, which is what was the participation by the  
14 defendant.

15 I'm hearing a lot of allegations of nonfeasance based  
16 on title but I'm hearing nothing as to what did he do  
17 directly or indirectly to induce the act constituting the  
18 violation, induce the act, not merely let it happen, and  
19 so, I would submit under the plain language of 20(a) and  
20 the logical conclusion of the Third Circuit decision in  
21 Rochez Brothers and In Re Suprema, that culpable  
22 participation in is an element that plaintiffs are going to  
23 require to prove for 20(a) liability. It's only logical  
24 you have to be able to plead it.

25 THE COURT: Let me hear from Dean Riccio.

1           MR. RICCIO: On the pleading versus proof dichotomy,  
2           the decision in In Re Able Labs, which is a 2008 decision  
3           from this district, Judge Greenaway I believe does a very  
4           detailed careful analysis of all of the cases back and  
5           forth and comes to the definite conclusion that, number  
6           one, culpable participation need not even be pled at all if  
7           the complaint says nothing about culpable participation.  
8           It still satisfies the pleading standard which is not the  
9           9(b) pleading standard but the 8(a)(2) pleading standard.  
10          So, we don't even need to plead culpable participation,  
11          although I think we did.

12           And while we were debating, your Honor, the  
13          sufficiency of the factual allegations regarding 10(b)(5)  
14          under the 9(b) standard, we're now only judged by the  
15          8(a)(2) standard, which, as your Honor knows, is much less  
16          demanding by way of detail than is the 9(b) standard.

17           As far as pleading -- I'm sorry -- as far as proving  
18          culpable participation is concerned, the Rochez case out of  
19          the Third Circuit may be the only -- and I don't want to  
20          say it is the only case -- but it might be the only case  
21          left in the circuit courts where culpable participation is  
22          required to be proven by the plaintiff as an element of the  
23          plaintiff's control person claim. Most other circuits, if  
24          not all others, say that the culpable participation is  
25          interwoven with the good faith defense that would be

1 available to the defendant in defending the 20(a) claim,  
2 so, where then does that leave us on Section 20(a)?

3 First of all, the underlying violation, which is an  
4 element of Section 20(a), is admitted. There's no dispute  
5 about that. Defendant's status as a control person is  
6 admitted. There's no argument about that. So, most 20(a)  
7 cases involve whether the person is a control person or  
8 not. We don't have that. Or whether there's an underlying  
9 violation that the control person controlled. We don't  
10 have that.

11 So, the only issue is pleading culpable  
12 participation. In Re Able Labs say you don't have to plead  
13 it. If you do have to plead it, it's under the 8(a)(2)  
14 standard, not the 9(b) standard, which then takes us to  
15 have we pled culpable participation. And I don't want to  
16 repeat everything I said before dramatically and non-  
17 dramatically to your Honor about culpable participation  
18 except to say that during my argument under 10(b)(5), your  
19 Honor suggested I might be making the same argument under  
20 20(a). I am. And everything I said in my argument about  
21 10(b)(5), (A), (B) and (C) is the evidence of culpable  
22 participation or the facts related to culpable  
23 participation that are in the complaint.

24 Also, your Honor, I would point out that in our brief  
25 we cited, in addition to In Re Able Labs, two other cases,



1 Kravitz and Henrickson, both of which recognize that a  
2 compliance officer who fails to implement a compliance  
3 program or doesn't enforce it, that is sufficient to  
4 satisfy the culpable participation requirement, not at the  
5 pleading stage but at the proof stage. So, we've alleged  
6 certainly -- I know counsel keeps saying we don't have much  
7 facts here. I mean, I beg to differ. It's a very detailed  
8 complaint. There was no rush to file the complaint. It  
9 was carefully done, I can assure your Honor, before we  
10 filed it.

11 We have certainly alleged that action and inaction  
12 can equate to culpable participation. As a matter of proof  
13 to prove your claim at the pleading stage, we have alleged  
14 action and inaction by the defendant made by virtue of his  
15 control person, by virtue of his -- the underlying  
16 violation we think that we have pled a culpable  
17 participation element even though under the Able case and  
18 others we don't need to plead it at all.

19 THE COURT: Now, just as a matter of curiosity, since  
20 certainly in taking that view the pleading and, indeed, the  
21 proof requirements under Section 20 are an awfully lot  
22 easier than 10(b)(5), why do we have these 10(b)(5)s here?

23 MR. RICCIO: Your Honor, they're pled in the  
24 alternative. I learned a long time ago not to put all your  
25 eggs in one basket. I don't file frivolous claims but if

1 we have a claim, I think we're duty bound under the RPCs to  
2 represent our client to the best of our ability. If that  
3 includes putting in claims that are harder to prove than  
4 others, that's what it is.

5 Come time for trial, after there's been some  
6 discovery and there's a scheduling order and pretrial order  
7 put in place, we may decide to abandon one or more claims  
8 to make our case simpler, but at this juncture at the  
9 pleading stage, I think we would probably be close to  
10 committing malpractice if we didn't put in all viable  
11 claims that we thought would survive a motion to dismiss,  
12 which is what we've done.

13 THE COURT: But as a practical matter, the Section 20  
14 claims are easier to prove --

15 MR. RICCIO: As a practical matter using our common  
16 sense, you are correct.

17 THE COURT: And there's no distinction in remedy, is  
18 there?

19 MR. RICCIO: I'm not sure. I don't want to say there  
20 is. I'm not aware of any but I don't know for sure, but I  
21 will be, hasten to say that because one claim is better  
22 than another doesn't mean that one should be dismissed  
23 because the other claim is stronger.

24 THE COURT: I'm not saying that.

25 MR. RICCIO: I know, just being careful, your Honor.

1 THE COURT: I'm just evaluating everything I've got  
2 and --

3 MR. RICCIO: Yeah, you're right. I mean, if you're  
4 asking me do I think the 20(a) claim is a better claim than  
5 the 10(b)(5) claim, I do. Some claims are better than  
6 others. But I also know what I think is the best claim  
7 isn't always what the judge thinks the best claim is.

8 THE COURT: All right. Let's go on to, we've got  
9 some state law claims here.

10 MR. RICCIO: Yes.

11 THE COURT: And in essence, what I've got from  
12 defense is that under New York law, all the fiduciary  
13 claims that you're asserting do not run to customers. The  
14 fiduciary duty of the officer runs to the corporation.  
15 That's the gist of your argument, is it not, Mr. Spada?

16 MR. SPADA: Correct, your Honor.

17 THE COURT: And he's cited a whole bunch of very  
18 distinguished Southern District judges who've interpreted  
19 New York law in that way, if I recall correctly.

20 MR. RICCIO: Well, your Honor, the first question, I  
21 don't want to get you embroiled in a choice-of-law issue  
22 but it is a choice-of-law question.

23 In their moving papers they said New York law governs  
24 and that was the end of it. I don't think that is the end  
25 of it because I believe on a motion to dismiss, the Harper

1 decision in this district says that you really shouldn't  
2 make ultimate choice-of-law determinations on a motion to  
3 dismiss for very good reasons. There's about 15 different  
4 factors that the courts will look at in deciding whether or  
5 not one particular state law or another state law governs.

6 At the end of the day, might New York law apply here?  
7 It might. It might as to some claims but not others. But  
8 you can really only decide what state law governs in this  
9 case based on the complaint, not based on what they're  
10 arguing.

11 But your Honor, you held me to the complaint and I  
12 will hold them to the complaint on the choice of law. And  
13 in the complaint, in paragraph two, it's very clear that  
14 relevant events and violations alleged in this complaint  
15 have occurred within this district, that the defendant  
16 transacts business in this district and is found in this  
17 district.

18 Now, that's all we know at this point about choice of  
19 law. That's all we really know. We also know, I guess,  
20 that BMIS was located in New York, but we don't know a  
21 whole lot more about the communications, the contacts with  
22 New Jersey, the confirmation statements and monthly  
23 statements. Where did they go? To the plaintiffs?

24 So, I think under Harper what you're supposed to do  
25 is stick to the complaint, apply the law that the complaint

1 would suggest should be applied, but defer ultimate  
2 determination until after discovery. Or in the  
3 alternative, you can order discovery, limit it to the issue  
4 of choice of law and we'll be happy to depose Peter Madoff  
5 on the issue of choice of law, but I suspect we'll  
6 encounter the same resistance that we encountered when we  
7 wanted to depose him previously. Notwithstanding the  
8 academic nicety of the choice-of-law issue, the reality is  
9 that in this case, I don't think it matters whether you  
10 apply New York or New Jersey state law to the state law  
11 claims because I think all of the state law claims survive  
12 under either jurisdiction's law.

13 Let me talk for a minute if I could, Judge, about the  
14 issue of Peter Madoff's duty to the plaintiffs. Their  
15 position is -- and I agree with this part of it -- the  
16 entity stands in the fiduciary relationship with the  
17 plaintiffs because the accounts that the plaintiffs opened  
18 with the entity were fully discretionary accounts and  
19 there's a decision by Judge Pisano, Pasternak, which says  
20 -- and New York decisions say the same thing -- that where  
21 you open up a fully discretionary account, there is a  
22 fiduciary relationship. So then the question is whether or  
23 not that fiduciary relationship between the entity and the  
24 plaintiffs carries over to the control persons.

25 There's only one case I know of that addresses this

1 issue and it's the Francis case and it's a New Jersey case.  
2 But there's nothing in New York saying otherwise. And  
3 here's what Francis says, and it's an interesting  
4 fascinating decision taught in the law schools even today.

5 Francis says that while a director of a corporation  
6 has a fiduciary duty to the shareholders, that director of  
7 the corporation can also have a fiduciary duty to  
8 nonshareholders who deposit money with the corporation that  
9 the corporation is holding in trust.

10 If you think about that for a minute, what the court  
11 is saying is that the fiduciary duty of the corporation --  
12 strike that -- of the directors to the shareholders crosses  
13 over to investors where the corporation is holding funds  
14 that are deposited with the corporation to be held in trust  
15 by the corporation.

16 That's exactly what happened here, only our case is  
17 one step better than Francis. We're not dealing with  
18 directors of a corporation who have far less control over  
19 the corporate affairs than a control person has in a  
20 control person setting, so, what we've argued under  
21 Francis -- and this is the theory -- that Peter Madoff, by  
22 virtue of his control status of the entity, had a fiduciary  
23 duty that derived from the entity's fiduciary duty because  
24 the entity was holding plaintiff's monies in trust for the  
25 benefit of the plaintiffs to be invested on a fully

1 discretionary basis, and where you have that unique type of  
2 setting which existed in Francis and which exists even more  
3 so here, Peter Madoff has a fiduciary relationship with the  
4 plaintiffs by virtue of his control status and by virtue of  
5 the fact that the funds invested by the plaintiffs were  
6 held by the entity on a fully discretionary basis. That's  
7 the theory under the direct fiduciary duty.

8 THE COURT: Mr. Spada, if I followed New Jersey law,  
9 would Francis hold Mr. Madoff in?

10 MR. SPADA: No, your Honor. While we submit that  
11 New York law does apply as laid out in our brief for the  
12 relevant factors, it doesn't matter, according to us. We  
13 think even under New Jersey law and the Francis case,  
14 there's still no duty owed based on the facts alleged here.

15 In the Francis case, it involved duty on the part of  
16 directors to take reasonable steps to protect clients  
17 against resulting misappropriation of entrusted funds.

18 There's no allegation in the complaint here that the  
19 defendant is a director or whether there was even any board  
20 of directors of what, according to the attachment to the  
21 complaint, was a single member LLC, so, while Francis  
22 involved a director, there's no allegation here that the  
23 defendant was even a director of the entity.

24 In any event, in Francis also, the action was not  
25 brought by an individual creditor. It was actually brought

1 by the company's bankruptcy trustees for the benefit of  
2 creditors. So, that to me sounds more like it's a duty  
3 derivative to the corporation, not a duty that an  
4 individual creditor has against an individual director  
5 because, again, the claim was being brought by the  
6 bankruptcy trustees for the benefit of all creditors, not  
7 for an individual creditor.

8 So, here not only don't we have a director, but we  
9 have -- it's an individual plaintiff trying to sue an  
10 individual defendant, which is a completely different  
11 situation. So, I don't believe that New Jersey law, the  
12 Francis case, changes how you resolve the duty issue.

13 And there's a Second Circuit case, Shearson Lehman  
14 vs. Wagner that talks about that a bankruptcy trustee has  
15 no standing generally to sue third parties on behalf of the  
16 estate's creditors but may only assert claims held by the  
17 bankrupt entity itself, which supports what Francis stands  
18 for, and also North American Catholic Education Programing  
19 vs. Gheewalla, a Delaware Supreme Court case that held that  
20 individual creditors of an insolvent corporation have no  
21 right to assert direct claims for breach of fiduciary duty  
22 against corporate directors.

23 So, you know, the Francis case, not only there was  
24 there a director involved, there's no director here, no  
25 allegation of a director, but also it was being brought on



1       behalf of all creditors, so, effectively on behalf of the  
2       estate, which is exactly in line with the New York case law  
3       which says while you may owe the duty to the corporation  
4       and the corporation may have some right, you don't owe the  
5       duty directly to the individual customers, clients,  
6       creditors.

7               THE COURT: All right. Anything further?

8               MR. RICCIO: Just one on the --

9               THE COURT: Certainly.

10              MR. RICCIO: We do allege that Peter Madoff is a  
11       senior managing director. We don't know exactly what that  
12       means at this juncture but there is a director status and  
13       we would also say, Judge, that, as I said a moment ago, the  
14       directors have less control over the affairs of a  
15       corporation than Peter Madoff did over BMIS by virtue of  
16       his control status, so if the director has the fiduciary  
17       relationship to nonshareholders by virtue of holding monies  
18       in trust, it almost flows inevitably that a control person  
19       who has greater control over the corporation should have a  
20       fiduciary relationship even more so than a director would.

21              MR. SPADA: And your Honor, I think the Court can  
22       take judicial notice that a managing director is an officer  
23       title in the corporation. It is not the same as being a  
24       director on a board of directors.

25              THE COURT: Anything further?

1           MR. RICCIO: And then if we're going to take judicial  
2 notice of that, let's take judicial notice of Mr. Madoff's  
3 duties and responsibilities.

4           THE COURT: All right. Thank you, folks. You'll get  
5 a decision as soon as possible.

6           MR. RICCIO: Thank you.

7           (Whereupon the proceedings are adjourned.)

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