EXHIBIT 1

(Part 1 of 3)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Debtor,	Adv. Pro. No. 08-01789 (BRL) SIPA LIQUIDATION (Substantively Consolidated)
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. SAUL B. KATZ, et al., Defendants.	Adv. Pro. No. 10-5287 (BRL) 11-CV-03605 (JSR) (HBP)

INITIAL EXPERT REPORT OF BRUCE G. DUBINSKY, MST, CPA, CFE, CVA, CFF, CFFA

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I. THE ASSIGNMENT

1. In June 2011, I was retained by the law firm of Baker & Hostetler LLP ("Baker") counsel for Irving H. Picard, Trustee ("Trustee") for the Substantively Consolidated SIPA Liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS") and Bernard L. Madoff ("Madoff"), to provide forensic accounting analysis and render certain expert opinions ("the Assignment") related to:
    - Whether or not BLMIS's Investment Advisory business (herein after referred to as "IA Business" or "House 17") was, in fact, a legitimate business; and
    - Whether or not House 17 was a "Ponzi" scheme.

II. EXPERT BACKGROUND AND QUALIFICATIONS

2. I am a Managing Director at Duff and Phelps, LLC ("D&P") and City Leader of D&P's Washington, D.C. office and was retained by Baker to serve as an expert witness in connection with the Assignment. My practice at D&P places special emphasis on providing forensic accounting and dispute analysis services to law firms litigating commercial cases, as well as corporations, governmental agencies and law enforcement bodies in a variety of situations.
3. I earned a Bachelor's of Science Degree in Accounting from the University of Maryland, College Park, MD and a Master's in Taxation ("MST") from Georgetown University, Washington, D.C. I am a Certified Public Accountant ("CPA"), Certified Fraud Examiner ("CFE"), Certified Valuation Analyst ("CVA"), Certified in Financial Forensics ("CFF") and a Certified Forensic Financial Analyst ("CFFA"), all in good standing, and was formerly a Registered Investment Advisor Representative.
4. I have been qualified and testified as an expert in various federal and state courts as an expert witness in the areas of forensic accounting and fraud investigations; bankruptcy; solvency; commercial damages; business valuations; investment theory; federal and state income taxation; abusive tax shelters; accounting ethics and standards; accounting malpractice; investment advisory issues; and a variety of other financial and tax matters. Additionally, I have professional experience in the area of computer forensics and related computer

investigations and have undergone training as a part of the fraud and forensic training as both a Certified Fraud Examiner and a Certified Forensic Financial Analyst.

5. Some of the more notable fraud and forensic accounting investigations that I have conducted include:
   - International Brotherhood of Teamsters–Campaign compliance and related fraud investigations for the International Officer Elections pursuant to the Consent Decree – S.D.N.Y., 1997-present [1];
   - Lehman Brothers Bankruptcy[2];
   - Washington Teachers Union fraud[3]; and
   - Firstpay payroll company fraud and Ponzi scheme.[4]
6. A current and accurate copy of my curriculum vitae and Federal Rules of Civil Procedure Rule 26 disclosures are attached hereto as Appendix "A."
7. The materials reviewed and considered in forming opinions and conclusions made in this report include documents and other data referenced herein and listed attached hereto as Appendix "B."[5] The opinions expressed herein are based upon my understanding of the facts in this case, as well as information gained during the course of D&P's performance of the Assignment. Further, I relied upon my education, training and over 28 years of professional experience, and my opinions and conclusions herein are stated to a reasonable degree of accounting certainty.
8. As litigation service engagements performed by Certified Public Accountants are deemed to be consulting services as defined by the American Institute of Certified Public Accountants ("AICPA"), my work on the Assignment was performed in accordance with the applicable standards as set forth in the Standards for Consulting Services established by the AICPA. Further, as a result of having other relevant professional certifications, as more fully described

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[1] *United States v. Int'l Bhd. of Teamsters*, No. 88 Civ. 4486 (LAP) (S.D.N.Y. 1989).
[2] *In re Lehman Brothers Holdings, et al.*, No. 08-13555 (JMP) (Bankr. S.D.N.Y. 2008).
[3] *United States v. Hemphill*, 514 F.3d 1350 (Ct. App. D.C. Feb 8, 2008); *United States v. Hemphill*, No. 03-CR-00516 (RJL) (D.D.C. 2003); *United States v. Bullock*, No. 03-CR-00345 (RJL) (D.D.C. 2003); *United States v. Holmes*, No. 03-CR-00032(RJL) (D. D.C. 2003).
[4] *Wolff v. United States*, 372 B.R. 244 (Bankr. D.Md. Aug. 3, 2007); *Wolff v. United States*, No. 03 30102 (PM) (Bankr. D. Md. 2006).
[5] *See* discussion *infra* regarding scope of documentation reviewed.

hereinafter, I adhered to the applicable standards of those governing organizations in the performance of my work in this matter and the rendering of these opinions.

9. Fact discovery in this case has not concluded as of the filing of this report, and related investigations are concurrently being conducted by various law enforcement agencies to determine the existence of possible criminal and/or civil violation acts of some of the individuals/entities described herein and others. Accordingly, this report is based upon the information available to me and reviewed to date, and I hereby reserve the right to supplement or amend this report in the event further additional information becomes available for my review.

10. In accordance with applicable professional standards of the Association of Certified Fraud Examiners, of which I am a member in good standing, this report contains no opinions on the guilt or innocence of any person(s) and/or party(s) named and/or discussed in the report.[6]

11. I am being compensated for my work in this matter at the rate of $750.00 per hour, and my fees are not contingent upon any finding or result in this matter.

III. SUMMARY OF ASSIGNMENT, SCOPE AND METHODOLOGY

A. Information Sources

12. Baker provided access to information, including but not limited to the following:[7]

- A database containing over 28 million documents representing, among other things: (1) customer statements; (2) bank account statements and other documents obtained through third-party subpoenas; (3) internal documents and correspondence from BLMIS; (4) and other documents, data, information and correspondence found on BLMIS's computer systems;

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[6] *Code of Ethics,* ACFE (last visited November 21, 2011), http://www.acfe.com/code-of-ethics.aspx. As there are parallel, ongoing criminal investigations and indictments pending in actions related to this matter, as well as a number of individuals who have pled guilty and are cooperating with the Federal authorities, independent interviews were not practicable or possible.

[7] Our access to documentation that was collected by the Trustee and made available to us was not limited in any manner and allowed D&P to search for information and documentation that both supported the opinions contained herein as well as any countervailing evidence, if any. A complete listing of the documents considered is included in Appendix "B" of this report.

- A database containing customer statement information compiled from underlying supporting documentation and bank account information compiled from underlying supporting documentation such as bank statements and wire transfer documents;
- Electronic media and records obtained from BLMIS's offices and storage facilities including nearly 19,000 backup tapes, hard drives, cell phones, Blackberry devices and other electronic information sources;
- Hard copy documents housed in a BLMIS-rented warehouse in Queens, NY containing over 11,000 large banker boxes of documents and information;
- Deposition transcripts for persons deposed by Baker as well as other transcripts in connection with the parallel liquidation proceeding in the United Kingdom;[8] and
- Visits to the BLMIS offices at 885 Third Avenue in Manhattan and to the BLMIS-rented Queens, NY document warehouse.

13. In addition to the information to which we were provided access, we obtained additional information where necessary to our investigation from publicly available sources. A complete listing is included in Appendix "B" of this report.

B. **Conduct of Information Review and Analysis**[9]

14. The work conducted by D&P in connection with the Assignment was planned, supervised and staffed in accordance with applicable professional standards. The work conducted by D&P included, but was not limited to:
    - Review and analysis of documents, emails, etc;
    - Review and analysis of various bank accounts of BLMIS and Madoff;
    - Review and analysis of customer statements, trade confirmations and other related documentation for House 17's customers dating as far back as records were available – back to the 1970s;

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[8] *MSIL v. Raven*, et. al., Claim No. 2010 Folio 1468.

[9] Records, documents and other information for certain periods were no longer available because the time period in question spans nearly 50 years (1960-2008). Nonetheless, the opinions contained herein are supported by available documentation, which include over 28 million documents dating back to the 1970s and by alternative analysis where historical documentation was no longer available.

- Review and analysis of certain purported trading activity for House 17's customers dating as far back as records were available--back to the 1970s;
- Review and analysis of certain trading activity for the market-making business ("House 5");
- Restoration, reconstruction, review and analysis of major portions of the AS/400 computer system utilized by House 17;[10]
- Review and analysis of certain third party information regarding BLMIS and/or House 17 purported trading activity;
- Review and analysis of certain accounting records;
- Review and analysis of certain vendor files and invoices for supporting documentation of expenses;
- Computer forensic analysis of electronic media evidence; and
- Review of deposition transcripts and other sworn testimony.

15. FTI Consulting, Inc. ("FTI"), hired directly by Baker, performed certain work and baseline analyses at the direction and supervision of Baker. Such was conducted largely before the retention of D&P. To the extent any such data was relied upon, or used to support analyses or the opinions herein, the accuracy of the data was tested by D&P to ensure reliability.[11]

16. Given the sheer volume of transactional data and documents in this investigation, a vast amount of analyses were performed using electronic computer analytics and data mining algorithms. Further, advanced computer models were developed and utilized for certain quantitative conclusions. Such analytics and models were developed and utilized consistent with applicable professional standards.

[10] *See infra* for description of computer systems.
[11] By way of example, statistical sampling was conducted on transactional data. Random samples of data were selected and underwent extensive testing, including "ticking and tying" of information to source documents (e.g., confirmation of information taken from historical microfilm customer statements or underlying bank statement transactional data).

IV. SUMMARY OF OPINIONS

17. This section is meant to provide only a brief summary of my expert opinions in this matter and to highlight the bases for such opinions which are fully discussed and supported hereinafter.

18. Based on my experience and the results of my investigation of BLMIS (described in detail throughout this report) I have concluded that: 1) the Investment Advisory business (i.e., House 17) was not a legitimate business; and 2) House 17 was a Ponzi scheme.

19. There is no evidence that the purported investment transactions for House 17 customers ever occurred at least as far back as the 1970s.[12] In fact, the evidence shows the trading did not occur. Reconciliations of: 1) House 17 equity positions to available BLMIS Depository Trust & Clearing ("DTC") records and 2) option trades with the available Options Clearing Corporation ("OCC") records indicate that no securities transactions were executed by House 17.

20. The so-called "convertible arbitrage trading strategy" purportedly implemented by BLMIS in the 1970s utilized fictitious trades that in many instances exceeded the entire reported market volume for the particular security on the day it was purportedly traded. On numerous trading days, trades were recorded at prices that did not represent true prices, as the prices reported for the purported trades were outside the range of market reported trading prices on a given day. Dividend payments and/or accrued interest were not reported by House 17 on many customer statements even though the real convertible securities paid such dividends and/or interest. Further, convertible securities were reported by House 17 as being traded on days after the actual date of conversion reported by the issuing corporation, thereby evidencing the fictitious nature of the purported trades. Lastly, there was no evidence that the purported convertible securities were ever actually converted, again supporting the fictitious nature of the purported trading activity.

21. The so-called "split-strike conversion strategy," purportedly put into place by BLMIS in the 1990s, utilized fictitious trades that in many instances exceeded the entire reported market

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[12] *See* discussion *infra* regarding David Kugel, who recently pled guilty to federal securities and related fraud charges on November 21, 2011 and stated that there was no legitimate trading in House 17 as far back as the 1970s. *United States v. Kugel* 10-CR-228, T'script of Plea Allocution DKT entry 11-21-11 (S.D.N.Y.) Nov. 21, 2011.

volume for the particular security on numerous trading days. Many purported trades were recorded at prices that did not represent true prices as the prices reported were outside the range of reported trading prices on a given day. House 17 supposedly executed 83 percent of the buy transactions by share volume below the Volume Weighted Average Price ("VWAP") and executed 72 percent of the sell transactions by share volume above the VWAP, statistics that evidence the fictitious nature of the trades.

22. Further, purported trades were recorded as being settled on weekends or holidays when the U.S. stock and option exchanges were closed and were also supposedly settled after the normal acceptable industry mandated time period of T+1 (for options) or T+3 (for equities), again supporting the opinion that these trades simply never occurred. In addition, billions of dollars of purported dividends earned that were reported on House 17 customer statements were fictitious and were never received by BLMIS, again showing the fictitious nature of the trades.

23. Additionally, House 17 created fake reports from the DTC trading clearinghouse which were designed, in part, by utilizing the IBM AS/400 computer system as well as PC-based systems. House 17 customer statements contained fictitious trades that were backdated using special software (STMTPro) modified in-house to reprint customer statements after the fact. Also, extensive in-house computer programs were created to conceal the fictitious investment transactions.

24. House 17 was "schtupping"[13] certain House 17 customers' purported investment returns utilizing a process to provide those customers with extra fictitious trades that were rigged to generate additional fictitious gains in order to reach pre-determined rates of return thresholds. The process involved a careful monitoring of certain accounts to ascertain levels of reported investment returns throughout the year and those that were falling short, were given additional fictitious trades, typically in December of that year, in order to bump the purported yearly returns to levels that House 17 had promised those customers.

25. Additionally, various regulatory reports were falsified to conceal the fictitious investment transactions utilizing false financial and other information.

[13] *See* discussion *infra* on the context surrounding the so-called "schtupping" of House 17 customer returns.

26. House 17 was a Ponzi scheme, utilizing new customer monies to fund its operations as well as to fund the withdrawal of fictitious profits and principal for its older customers. The Ponzi scheme had been operating for many years as is evidenced by the fact that House 17 was not generating any legitimate profits since no trading activity was taking place. Additionally, House 17 was not receiving legitimate financial support from House 5 in amounts sufficient to satisfy the cash requirement needs of the House 17 customer withdrawals and House 17 was not receiving any legitimate outside financial support vis-à-vis loans or otherwise.

27. As further proof of the illegitimate nature of House 17 and to support the opinion that House 17 was a Ponzi scheme, the overall solvency of BLMIS was assessed. Businesses operating as a Ponzi scheme are hopelessly insolvent by their very nature. As further proof, a solvency analysis was conducted and it was determined that BLMIS was insolvent as of at least December 11, 2002 (a date selected by counsel for the six-year period prior to BLMIS's bankruptcy filing, "Valuation Date"). BLMIS's customer liabilities were approximately $12 billion as of December 11, 2002, far exceeding the fair market value of its assets by $10 billion dollars.

V. FACTUAL BACKGROUND[14]

A. Bernard L. Madoff Investment Securities

28. In 1960, Madoff founded BLMIS as a sole proprietorship. BLMIS, a market making business in Over-the-Counter stocks ("OTC"), was registered as a broker-dealer with the Securities and Exchange Commission ("SEC") as of January 19, 1960[15] and operated three business units: (1) a market making business; (2) a proprietary trading business (together with the market making business known inside BLMIS as "House 5"); and (3) an investment advisory business (known as the IA Business or inside BLMIS as House 17).

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[14] My understanding of the factual background is based upon various sources of information including the pleadings in this case, deposition transcripts and/or testimonial transcripts in connection with the parallel liquidation proceeding in the United Kingdom, and documents where footnoted. This recitation of the factual background serves to provide only a background summary of the facts as I understand them. It is my understanding that the foundation for the facts set forth in this section of my report will be laid out at trial through evidentiary materials and will form the factual predicate for any opinions contained herein that are based upon such facts.

[15] Form BD for Bernard L. Madoff, December 31, 1959. PUBLIC0003607-PUBLIC0003614

29. In 1987, BLMIS moved from its location at 110 Wall Street to the iconic "Lipstick Building" located at 885 Third Avenue in Manhattan, eventually leasing the 17th, 18th, and 19th floors.[16] House 5 was located on the 18th and 19th floors.[17] Eventually, House 17 moved from the 18th floor to the 17th floor.[18]

30. In 2001, BLMIS was reorganized as a single-member LLC with Madoff as the sole member.[19]

31. In August 2006, BLMIS registered as an investment adviser with the SEC claiming to have 23 accounts and $11.7 billion in assets under management.[20]

32. During 2008, House 17's cash reserves dwindled to the point where customer redemption requests exceeded the cash balance available. At his plea hearing on March 12, 2009, Madoff confessed to federal authorities that the IA Business was a fraud.[21]

B. House 17 Operations

33. The House 17 customer accounts were administered in two groups: (1) the split-strike conversion accounts; and (2) the non-split-strike conversion accounts (which included the convertible arbitrage accounts).

34. A convertible arbitrage trading strategy aims to generate profits by taking advantage of the pricing mismatches that can occur between the equity and bond/preferred equity markets. This strategy is implemented when the bond market or preferred equity market is incorrectly valuing the option component of the security relative to the underlying common stock price. The investor is looking then to benefit from a change in the expectations for the stock or bond over a period of time (*see* discussion *infra* for additional details on convertible arbitrage).

35. The split-strike conversion accounts were overseen by Frank DiPascali ("DiPascali").[22] This group of accounts employed a strategy which purported to invest in a basket of common stocks within the S&P 100 Index which was hedged by call and put options to limit customer gains and losses. Madoff would purportedly decide when to unwind positions upon which the

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[16] Bernard L. Madoff Lease Summary 885 Third Avenue. CWIE-BR00002468
[17] LAZAA0004351- LAZAA0004352
[18] Bernard L. Madoff Lease Summary 885 Third Avenue. CWIE-BR00002468
[19] BLMIS Articles of Incorporation for New York State. MADTSS01160346
[20] BLMIS ADV Form at 8, Aug. 25, 2006. PUBLIC0003729
[21] *See United States v. Madoff*, No. 09-CR-213 (DC), Transcript of Plea Allocution of Bernard L. Madoff at 23, ECF No. 50 (S.D.N.Y. March 12, 2009).
[22] *See generally*, *Frank DiPascali*, No. 09-CR-764 (RJS), Plea Allocution, Dkt. Entry 8/11/2009 (S.D.N.Y. 2011); *United States v. Frank DiPascali*, No. 09-CR-764(RJS), Information, ECF No. 7 (S.D.N.Y. 2011).

stocks were sold and the investments were moved into U.S. Treasuries and/or money market funds and cash reserves.

36. The non-split strike conversion accounts initially represented a significant portion of overall House 17 accounts, but became a small percentage of total House 17 accounts in the 1990s. Generally, the non-split-strike conversion accounts were titled in the name of BLMIS's oldest House 17 customers.

37. Although BLMIS was touted as one of the most technologically advanced brokerages in the country and was widely acknowledged as being "at the forefront of computerized trading,"[23] as is discussed hereinafter, House 17 neither provided its customers with electronic customer statements nor was there real-time access to their individual House 17 accounts at BLMIS.

C. **Madoff Securities International Limited**

38. In February 1983, BLMIS established its foreign operations with the registration of Madoff Holdings Limited in London.[24] In September 1988, Madoff Holdings Limited began operating as Madoff Securities International Limited ("MSIL").[25] MSIL operated under the Financial Services Authority (and its predecessors) in the U.K.[26] and became one of the first U.S. members of the London Stock Exchange.[27] As of December 31, 2007, MSIL employed approximately 25 people.[28]

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[23] BLMIS web archive Oct. 23, 2005, http://web.archive.org/web/20051023123110/http://www.madoff.com/dis/display.asp?id=20 (last visited Aug. 1, 2011).
[24] Madoff Holdings Ltd. Incorporation documents. PUBLIC0006083
[25] "Special Resolution" indicating that Madoff Holdings Ltd. changed its name to Madoff Securities International Limited). PUBLIC0008959
[26] MSIL Financial Statement and Directors Report. PUBLIC0005755 at PUBLIC0005757
[27] BLMIS website, Oct. 23, 2005, http://web.archive.org/web/20051023123110/http://www.madoff.com/dis/display.asp?id=20 (last visited Aug. 1, 2011).
[28] MSIL Financial Statement and Directors Report. PUBLIC0005785 at PUBLIC0005798

D. **Key Individuals**

i. Bernard L. Madoff

39. Madoff was the principal of BLMIS and oversaw both House 5 and House 17 businesses.[29]

40. On December 11, 2008, Madoff was arrested for securities fraud and related charges.[30]

41. On March 12, 2009, Madoff pled guilty to 11 counts of an indictment including federal securities fraud and related offenses.[31]

42. On June 29, 2009, Judge Dennis Chin sentenced Madoff to the maximum of 150 years in federal prison.[32]

ii. Frank DiPascali

43. DiPascali started at BLMIS in 1975 right after he graduated from high school.[33] Over his years with BLMIS, he worked as a research analyst, options trader,[34] in addition to other roles.[35] DiPascali managed House 17 and was critical to the day-to-day activities of the IA Business, interfacing with clients and overseeing House 17 employees.[36]

44. In 2009, DiPascali was charged with a ten count criminal information, and he subsequently entered into a plea agreement. In his plea allocution, DiPascali admitted to learning of the fraud in the late 1980s or early 1990s, and he stated that no purchases or sales of securities actually took place in the client accounts.[37] Instead, DiPascali created fraudulent account

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[29] BLMIS ADV Form at 23, Aug. 25, 2006. PUBLIC0003729 Madoff served as Chairman of the Board of Directors of NASDAQ in 1990, 1991, and 1993, and was a member of the Board of Governors for NASD. BLMIS website, Oct. 23, 2005, http://web.archive.org/web/20051023123110/http://www.madoff.com/dis/display.asp?id=20 (last visited Aug. 1, 2011).

[30] *United States v. Madoff*, 586 F.Supp.2d 240, 244 (S.D.N.Y. 2009).

[31] *United States v. Madoff*, 09-CR-213, Plea Allocution at pp. 7-8, ECF No. 50 (S.D.N.Y. March 12, 2009).

[32] *Id.* at 49. In his plea allocution, Madoff admitted to operating a Ponzi scheme "to the best of his recollection" from the early 1990s until December 2008. Additionally, he stated that no securities had ever been purchased on behalf of the House 17 customers. *Id.* at 24, 29. While I have considered information contained in Madoffs' plea allocution, my opinions in no way are predicated or based upon information contained therein and as set forth herein my investigation contradicts the duration of fraud claimed by Madoff. Moreover, David Kugel recently pled guilty in this matter *(see* discussion *infra*) and has admitted that the fraud started in the early 1970s at House 17 and that no trading activity actually took place for House 17 customers, further supporting my opinions contained in this report. Information contained in the Madoff plea allocution was considered solely as part of the record in this matter.

[33] *United States v. DiPascali*, No. 9-CR-764, Plea Allocution at 45, Dkt. Entry 08/11/2009 (S.D.N.Y. Aug. 11, 2009).

[34] *Id.*

[35] *Id.* at 47.

[36] *Id.*

[37] *Id.* at 46.

statements using information gleaned from historical stock data to create the returns that Madoff had promised the clients.[38]

45. On August 11, 2009, DiPascali pled guilty to federal securities fraud and related offenses. DiPascali is facing 125 years in prison, but has yet to be sentenced.

iii. David Kugel

46. David Kugel ("Kugel") worked for BLMIS for more than 40 years, originally starting in 1970.[39] Prior to working for BLMIS, Kugel worked as a trader specializing in convertible securities.[40] For BLMIS, Kugel purportedly traded in convertible securities and applied an arbitrage strategy to these stocks, buying both the convertible security and then shorting the underlying stock.[41] This arbitrage strategy is similar to the purported strategy that BLMIS claimed to employ in the House 17 accounts from at least the 1970s to the 1990s.[42]

47. On November 21, 2011 (just one day before this report was issued), Kugel pled guilty to federal securities fraud and related offenses, admitting that the investment fraud at House 17 started in the 1970s.[43] Kugel is awaiting sentencing.[44]

iv. Annette Bongiorno

48. Annette Bongiorno ("Bongiorno") worked at BLMIS from July 1968 until December 11, 2008.[45] She managed hundreds of House 17 accounts and supervised House 17 employees including the key punch operators responsible for entering the purported trades.[46] Many of

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[38] *Id.* at 47.
[39] *United States v. Kugel*, 10 Cr. 228 (LTS), Plea Allocution at 35-36 (S.D.N.Y. Nov. 21, 2011).
[40] *See generally*, Kugel Plea Allocution *supra*.
[41] *See generally*, Kugel Plea Allocution *supra*.
[42] *See infra* on convertible arbitrage strategy.
[43] "As to Counts One, Three, Four, and Five, I provided historical trade information to other BLMIS employees, which was used to create false, profitable trades in the Investment Advisory clients' accounts at BLMIS. Specifically, beginning in the early '70s, until the collapse of BLMIS in December 2008, I helped create fake, backdated trades. I provided historical trade information – sorry - first to Annette Bongiorno, and late to Joanne Crupi, and others which enabled them to create fake trades that, when included on the account statements and trade confirmations of Investment Advisory clients, gave the appearance of profitable trading when in fact no trading had actually occurred. I helped Bongiorno, Crupi and others create these fake, backdated trades based on historical stock prices and were executed only on paper." *United States v. Kugel*, 10 Cr. 228 (LTS), Plea Allocution at 32 (S.D.N.Y. Nov. 21, 2011).
[44] *See U.S v. Kugel*, No. 10-CR-228 (LTS), Information (S.D.N.Y. Nov. 21, 2011).
[45] *United States v. Bongiorno*, No. 10-CR-228, Superseding Indictment at pg. 5, ECF No. 36 (S.D.N.Y. Nov. 17, 2010).
[46] *Id.*

the accounts that Bongiorno managed were close friends and family of Madoff and BLMIS employees, and included some of the oldest Madoff clients.[47]

49. Bongiorno was charged with federal securities fraud and related offenses on November 18, 2010.[48] She is awaiting trial.

v. Daniel Bonventre

50. As BLMIS's Director of Operations, Daniel Bonventre ("Bonventre") ran the back office at BLMIS and oversaw the firm's accounting and securities clearing functions for at least 30 years.[49] He was responsible for overseeing the accounting functions for both House 17 and House 5, including maintenance of the BLMIS general ledger.[50] Bonventre provided information used in the creation of the Financial and Operational Combined Uniform Single ("FOCUS") reports and the BLMIS financial statements.[51]

51. Bonventre was charged with federal securities fraud and related offenses.[52] Bonventre is awaiting trial.

vi. Eric Lipkin

52. Eric Lipkin ("Lipkin") started at BLMIS in the mid-1980s and by 1992 was working in BLMIS's payroll and benefits department, processing the payroll and administering the BLMIS 401(k) plan.[53] In approximately 1996, Lipkin began working with Bongiorno, Bonventre, DiPascali, Jodi Crupi, Jerrry O'Hara, and George Perez to maintain false customer accounts, with Lipkin creating letters to clients indicating the purported balances in their BLMIS accounts.[54]

53. Lipkin admitted to manufacturing customer statements to reflect the false holdings of customer accounts, as well as, falsifying the books and records of BLMIS. Lipkin was

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[47] *See generally*, Bongiorno Indictment *supra* at 45.
[48] Bongiorno, Indictment at pp. 70-96.
[49] *United States v. Bonventre*, No. 10-CR-228 (LTS), Superseding Indictment at pp. 60-92, ECF No. 36-1 (S.D.N.Y. Nov. 17, 2010).
[50] *Id.* at p. 4.
[51] *Id.* at 51.
[52] *United States v. Bonventre*, No. 10-CR-228 (LTS), Superseding Indictment at pp. 60-92, ECF No. 36 (S.D.N.Y. Nov. 17, 2010).
[53] Press Release, U.S. Attorney's Office, *Manhattan Attorney Announces Guilty Plea Of Another Employee Of Bernard L. Madoff Investment Securities LLC*, (June 6, 2011); *United States v. Lipkin*, No. 10-CR-228 (LTS), Information at pg. 5, ECF No. 138 (S.D.N.Y. June 6, 2011).
[54] *Id*. at 5-6.

charged with federal securities fraud and related offenses.[55] Lipkin entered into a cooperation agreement and on June 6, 2011, pled guilty to all six counts.[56] Lipkin awaits sentencing.

vii. Joann "Jodi" Crupi

54. Joann "Jodi" Crupi ("Crupi"), who worked for BLMIS for approximately 25 years,[57] performed many tasks for BLMIS. Crupi tracked the daily activity in the primary checking account for the IA Business operations (the "703 Account") to ensure there was enough money for pending redemptions, and she authorized wire transfers into and out of the account. Crupi created a Daily Report, delivered to Madoff every day, which reflected the 703 Account balance, customer deposits, and all pending customer redemptions.[58] Similar to Bongiorno, Crupi was also responsible for managing several House 17 customer accounts,[59] for which she manufactured statements in order to produce the promised rates of return.[60]

55. Crupi was charged with federal securities fraud and related offenses on November 18, 2010.[61]

viii. Jerry O'Hara and George Perez—Computer Programmers

56. Jerry O'Hara ("O'Hara") was hired in 1990 as a programmer in House 17 to create and maintain the systems and functions that falsified customer account statements. George Perez ("Perez") was hired in 1991 to assist O'Hara. Perez and O'Hara's programs and systems created fake trade blotters and reports.[62] Additionally, they maintained the systems that falsified the trading data using historical stock prices to manufacture the customer statements and other reports sent to customers.[63]

57. O'Hara and Perez were both charged with federal securities fraud and related offenses.[64] O'Hara and Perez await trial.

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[55] *Id.* at 7.
[56] *United States v. Lipkin*, 10-CR-228 (LTS), Cooperation Agreement, ECF No. 138 (S.D.N.Y. June 6, 2011); *United States v. Lipkin*, 10-CR-228 (LTS), Minute Entry, Dkt. Entry 06/06/11 (S.D.N.Y. June 6, 2011).
[57] *United States v. Crupi*, No. 10-CR-228 (LTS), Superseding Indictment at pp. 5, ECF No. 36 (S.D.N.Y. Nov. 17, 2010).
[58] *Id.* at 5-6, 44-45.
[59] *Id.* at 14-15, 20-21, 25-26.
[60] *Id.* at 14-15, 20-21, 25-26, 33-37.
[61] *Id.* at 60-92, 94-95.
[62] *Id.* at 27-38.
[63] *See* MDPTTT00000001- MDPTTT00002748
[64] *United States v. Bonventre*, No. 10-CR-228 (LTS), Superseding Indictment, ECF No. 36 (S.D.N.Y. Nov. 18, 2010).

ix. Friehling and Horowitz

58. The BLMIS financial statements were purportedly audited by Friehling and Horowitz, C.P.A., P.C. ("F&H"), a three-person CPA firm.[65]

59. Jerome Horowitz ("Horowitz"), a licensed CPA in the State of New York,[66] worked for Alpern & Avellino before establishing his own accounting firm. Saul Alpern was Madoff's father-in-law and founder of the accounting firm. When Horowitz retired, his firm retained the Madoff account and continued to perform the tax and audit services for the Madoff brokerage firm. These duties were transitioned to David G. Friehling ("Friehling") when Horowitz retired.

60. On November 3, 2009, in the United States District Court Southern District of New York, Friehling pled guilty to federal securities fraud and related offenses.[67]

61. As a result of the plea, Friehling was forced to surrender his CPA license to the State of New York and is currently awaiting sentencing.

E. Computer Systems Overview

62. In operating either a market-making business or an investment advisory business such as BLMIS, a minimum amount of computer hardware, software and connections to information sources and regulatory systems is required. Often, firms engaged in market trading activities develop information technology systems that enable and facilitate certain key functions, such as customer management and provision of timely market information.

63. Customer management systems obtain information from clients regarding deposits, market orders and withdrawals, as well as verify the accuracy of the same. Market information systems facilitate timely communication of news and current market information instrumental to investing decisions. This information may come from third party vendors, such as Bloomberg, Dow Jones, and Thomson Reuters, as well as directly from the financial

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[65] *See* Audit Report to the 2000 audited financial statements. MADTEE00046020
[66] Office of the Professions, New York State Education Department (Nov. 20, 2011), http://www.nysed.gov/coms/op001/opsc2a?profcd=07&plicno=017210&namecheck=HOR.
[67] *United States v. Friehling*, No. 09-CR-700, Plea Agreement, Dkt. Entry 1/3/09 (S.D.N.Y. Nov. 3, 2009).

exchanges, such as NASDAQ. Systems that integrate customer management and market information systems aid in the trading and investment divisions' interaction with trading markets by, among other things, identifying investment opportunities and generating optimal execution strategies.

64. The following table provides a summary of the key systems, both hardware and software, implemented in House 5 and House 17.

Table 1

Name	**Description**	**House 5**	**House 17**
ACES	Routed orders between order-entry firms and market makers that have established relationships with BLMIS.	✓	
Bloomberg	Provided nearly instant financial and economic data.	✓	✓
Connectivity Overview	Approximately 80 connections to handle order flow. These systems included extranet providers, private lines and VPN internet connections.	✓	**Limited**[68]
CTCI Circuit	Reported trades to tape and cleared trades through the NASDAQ/Trade Reporting Facility ("TRF") and received trade acknowledgements.	✓	
Custom Software	Software used to identify customer accounts, individual securities, trading activity, pricing, dividend and proxy information, checks and other information related to maintaining the accounts.		✓
Custom Software	Custom software printed customer statements and storing optical images.		✓
Data Warehouse	An Oracle database that received and processed data from various transactional databases and systems.	✓	
DTC System	Enabled securities movements for NSCC's (described *infra*) net settlements and settlement for institutional trades.	✓	

[68] House 17 had very limited connectivity capabilities that basically consisted of an internet connection and an FTP site. No connections to DTC or exchanges were identified and/or found.

Name	**Description**	**House 5**	**House 17**
Fix Engine	Facilitates electronic communication of trade-related messages between equity market participants by incorporating the free Financial Information eXchange ("FIX") protocol, JAVA, XML and TIBCO integration technologies.	✓	
FormsPrint	Created forms that overlaid files generated on the AS/400 in order to simplify printing.		✓
IBM Application System 400 ("AS/400")	A popular system for small and intermediate sized companies, that hosted its information systems.	✓	✓
M2	A proprietary order entry and management system that was integrated with the MISS system.	✓	
Maid	Provided to query and review executions and make corrections in a batch process rather than one at a time.	✓	
MIMIX	Provided backup and disaster recovery functionality.	✓	✓
MISS	A central order management system for most trading activities, including market making and proprietary activities. MISS handled, on average, 400,000 trades a day with a capacity of over 1.4 million executions.	✓	
Muller	Delivered bond and dividend announcement data.	✓	
NASDAQ QIX	Provided real-time market data and trading system.	✓	
Order Audit Trail System (OATS)	Tracked order events, including the origination, transmission and the cancellation or execution.	✓	
Report Program Generator ("RPG")	Custom software that facilitated the generation of customer statements through manual entry, as well as interaction with House 5 systems.	✓	✓
ROBO and Blackbox	Trading platforms that executed trades and managed Profit and Loss accounting.	✓	

Name	Description	House 5	House 17
Securities Industry Automation Corporation ("SIAC")	Provided real-time market data from SIAC's Consolidated Tape/Ticker System ("CTS") and Consolidated Tape Association ("CTA").	✓	
Settled Cash (SETCSH17)	Data file of customer account activity.		✓
STMTPro	Revise customer statements from previous months if necessary.		✓
StorQM	Off-the-shelf product that enabled viewing and managing legacy reports.		✓
Stratus VOS	Front-end processing system to maximize trading speed.	✓	
Superbook	A component of the M2 system that provided a consolidated view of all available market data for a particular security.	✓	
Thomson One	Provided trading functions.	✓	
Ticker Plant	An architecture system for data distribution.	✓	
Time and Sales	Used by clients to view their historical trade data.	✓	
Time Slicing Web Applications	Customer order portal that enabled registered clients to enter and track orders.	✓	

65. As discussed in greater detail later in this report, while House 5 had robust computer systems that one would expect to see in a broker-dealer trading environment, the dearth of such comparable systems in House 17 is in stark contrast and shows that trading in House 17 did not occur.

VI. EXPERT OPINIONS

A. OPINION NO. 1: HOUSE 17 WAS NOT A LEGITIMATE BUSINESS.[69]

i. Fictitious Trading in House 17 - There is no evidence that the purported investment transactions for House 17 customers ever occurred at least as far back as the 1970s. In fact, the evidence shows the trading did not occur.[70]

a. The Purported Convertible Arbitrage Strategy – the 1970s to the 1990s: There is no evidence that the purported convertible arbitrage strategy for House 17 customers actually occurred. In fact, the evidence proves that the purported trades did not occur.

66. Convertible securities are generally fixed income and preferred equity instruments that allow the purchaser to convert that security to shares of stock under pre-specified conditions set forth by the issuer. Although there can be a myriad of covenants for convertible securities, the most common conditions include a pre-determined strike price (i.e., price at which the securities can be converted) and a pre-determined timeframe necessary in order to convert the security into shares of common stock.[71]

67. Corporate convertible securities include the following:

- Convertible Bonds: Corporate bonds that can be converted to company equity at some predetermined ratio during a certain period of time.
- Warrants: Similar to call options in that they provide an investor with the right (but not the obligation) to purchase a security at a predetermined price during a certain period of time, but issued by the company usually as a benefit to bondholders.
- Convertible Preferred Stock: Preferred stock that can be converted to common equity at some predetermined ratio during a specified period of time.

68. A convertible arbitrage trading strategy aims to generate profits by taking advantage of the pricing mismatches that can occur between the equity and convertible instruments. This

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[69] I am using the plain English meaning of the term "legitimate" to mean "*being exactly as purposed: neither spurious nor false.*" *See* Legitimate, Merriam Webster (Nov. 20, 2011), http://www.merriam-webster.com/dictionary/legitimate. Further, I am not opining on the trading activities or other business activities of House 5 beyond its relevance to my opinions related to House 17.

[70] All discussion and opinions related to trading activities or positions held in House 17 are assumed herein to be purported, including, but not limited to, all references to "trades," "securities held" or "trading." The opinion herein encompasses the convertible arbitrage and split strike conversion trading strategies for House 17 which were the trading strategies utilized for nearly all of its customers. A few self-directed trades for a single IA Business customer were identified as being purportedly executed through House 5. The *de-minimis* number of these transactions does not impact my opinions herein.

[71] Frank J. Fabozzi, The Handbook of Fixed Income Securities, 1372 (7th ed. McGraw Hill 2000).

strategy is implemented when the convertible instrument is incorrectly valuing the option component of the security relative to the underlying common stock price. The investor is looking then to benefit from a change in the expectations for the stock or convertible security over a period of time.

69. Normally, this arbitrage is initiated by simultaneously purchasing convertible securities and selling short enough shares of the underlying common stock to create a delta neutral hedge. ("Delta neutral" implies that the investor is protected from price movement of the common stock.)[72]

70. With this trading strategy, if the underlying stock loses value, the potential arbitrageur will benefit from the short sale of the stock, while still receiving constant interest payments to the extent the underlying instrument was a bond. Conversely, if the stock price improves in value, the loss on the short sale will be mitigated by the increase in the option value of the underlying security.

(i) Convertible arbitrage strategy - House 17 Customers

71. During the 1970s through the mid-1990s, Madoff purportedly utilized a convertible arbitrage investment strategy. House 17 customer statements suggest that this purported trading strategy occurred, in theory, as the statements showed long convertible positions, corresponding short positions, and positions converted and unwound (i.e., the short positions were purchased back and/or the convertible security was sold).

72. In order to investigate House 17's purported convertible arbitrage strategy, customer transactions and statements were analyzed both in aggregate (i.e., across all customer accounts) and on an individual customer account basis. The months of October 1979, November 1979 and March 1981 were utilized and included all customer accounts that held funds with BLMIS at that time.[73] In addition to the three sample months, eight Avellino &

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[72] Arshanapalli, New Evidence on the Market Impact of Convertible Bond Issues in the U.S. 17-18 (2005).
[73] The customer ledger data for these three months were fully coded into a database by the Trustee's consultants.

Bienes[74] ("A&B") accounts were utilized and analyzed from November 1978 through to the date when the accounts transitioned to the purported split strike conversion strategy.[75]

73. For the relevant time period, House 17 customer statements purportedly employing the convertible arbitrage strategy were tested against historical, independent market trading records for the applicable securities.[76] The daily price range, total daily volume and corporate actions (e.g., dividends) of each security in question were analyzed in comparison to those identified on the customer statements.

74. An example of how the purported transactions in House 17 were constructed can be seen in Table 2 below. Customer statements from House 17 depicted that the clients were long in convertible securities and short in the underlying common stock. In this instance, the statement purports the customer was long Macmillan Inc. convertible debentures and short the underlying common stock. However, as described in the following paragraphs, there are a number of reasons why this trade, as presented (as well as the majority of the House 17 convertible arbitrage transactions in general) could not have occurred.

Table 2

A&B 1A0045 Account – Macmillan Inc Sub Deb Conv 8.75 – Due 2/15/2008

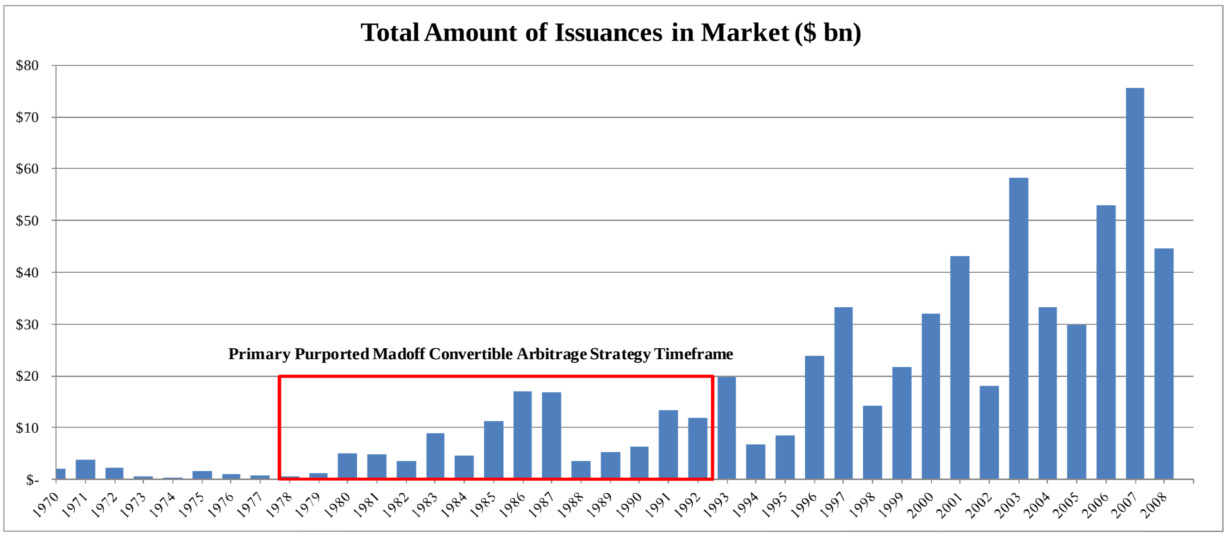
	Bates	Statement Date	Transaction Date	Long	Short	Security	Price	Debit	Credit
A	MF00370649	1/31/1985	9-Jan	706,000		MACMILLAN INC SUB DEB CONV 8.750 2/15/2008	138	$ 1,000,191.12	
B	MF00370649	1/31/1985	9-Jan	705,000		MACMILLAN INC SUB DEB CONV 8.750 2/15/2008	138	998,774.42	
C	MF00370649	1/31/1985	10-Jan		41,300	MACMILLAN INC	44 7/8		$ 1,853,337.50
D	MF00370649	1/31/1985	10-Jan		5,152	MACMILLAN INC	44 3/4		230,552.00
E	MF00370649	1/31/1985	17-Jan			MACMILLAN INC FRACTIONAL SHARES	JRNL		30.20
F	MF00371844	3/31/1985	14-Mar		705,000	MACMILLAN INC SUB DEB CONV 8.750 2/15/2008	DELV		
G	MF00371844	3/31/1985	14-Mar	41,300		MACMILLAN INC	RECD		
H	MF00371844	3/31/1985	14-Mar		706,000	MACMILLAN INC SUB DEB CONV 8.750 2/15/2008	DELV		
I	MF00371844	3/31/1985	14-Mar	5,152		MACMILLAN INC	RECD		
							Total	$ 1,998,965.54	$ 2,083,919.70

[74] A detailed overview of A&B is discussed *infra* in this report.
[75] These accounts include: 1A0045 through 1A0051 and 1B0018. As noted *supra* in this report, the underlying data used in these analyses were validated and tested. These eight accounts were utilized as the customer data associated with these accounts were fully coded by the Trustee's consultants into a database.
[76] New York Stock Exchange Daily Stock Records, Over the Counter Exchange Daily Stock Records, American Stock Exchange Daily Stock Record, Wall Street Journal New York Exchange Bonds, and Moody's Industrial Manuals.

(ii) Purported convertible security trades exceeded the entire reported market volume for certain days.

75. Given there were relatively few actual convertible securities issued during the timeframe House 17 purportedly utilized this strategy (i.e., 1970s through mid-1990s) (*see* Figure 1), it would have been highly unlikely to find adequate trading volume necessary to generate the dollar returns that appear on the customer statements in this timeframe.[77]

Figure 1



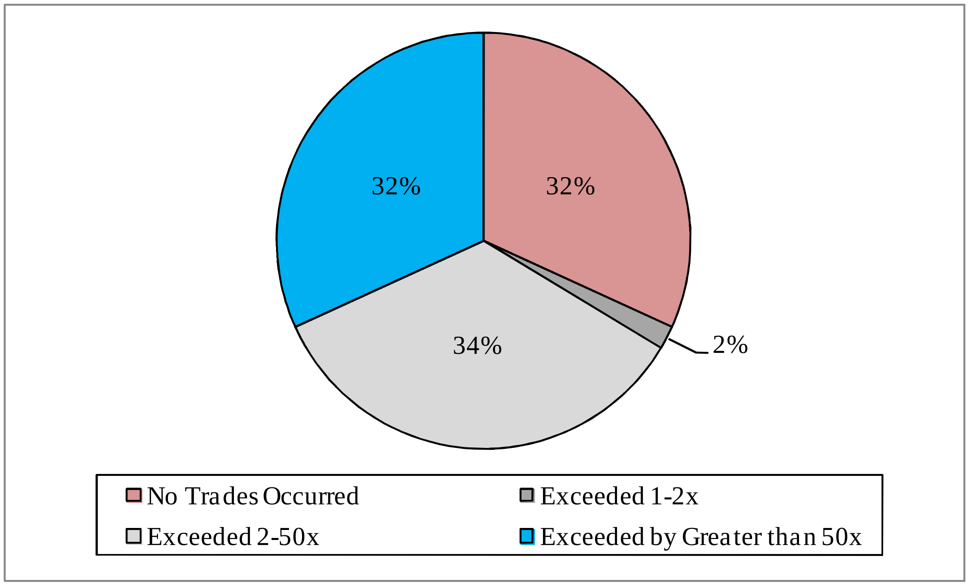
76. To test if the purported trades could have been legitimate, the daily volume from the long convertible positions as indicated on the customer ledgers were compared to the historical market volume for those securities on the specific days the trades purportedly occurred. Customer ledgers from the three months, October 1979, November 1979 and March 1981 were analyzed to aggregate the relevant transactions to be tested. 117 unique convertible security transactions were compared to historical daily trading volume of these securities.[78] Of these securities, 110 of the 117 unique convertible securities that resulted in purported trades (95%) exceeded the daily market volume traded for that day by an average of over 150

[77] SDC Database of Convertible Securities Issuances, includes only issuances greater than $100 million. Frank Fabozzi, Jinlin Liu, & Lorne N. Switzer, *Market Efficiency and Returns from Convertible Bond Hedging and Arbitrage Strategies* (2009).
[78] There were 66 additional instances where publicly available market data could not be identified.

times the entire reported daily volume for all trades in the market.[79] In fact one security, UAL Inc. Preferred Security A, purportedly traded nearly 1,219 times the actual daily volume, a fact that shows the purported trades were fictitious.[80]

Figure 2

Breakdown of Purported Securities Exceeding Daily Volume for Three Months



77. To further test the volume analysis, eight A&B accounts were tested to determine whether the transactions exceeded the actual daily market volume for the chosen convertible securities between 1978 and 1998 ("A&B Time Period").[81] The daily historical volume for the convertible securities was compared to the volume House 17 purportedly traded per the customer account records, and results were similar to that of the three months analysis

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[79] A volume analysis was also performed for all the common equity that was shorted for the transactions executed during these three months. Data was collected from the Daily Stock Price Record-New York Stock Exchange and the Daily Stock Price Record-American Stock Exchange, which provide the end-of-month short positions. The purported House 17 month-end short positions for these three months were then compared to the publicly available data. The investigation concluded that of the 166 short positions for which data was publicly available, 57% of the House 17 purported short common shares positions exceeded the daily historical volume for the common shares. In fact, one position exceeded the daily volume by approximately 270 times the actual reported total market short position.

[80] Two of the largest European exchanges (London Stock Exchange and the Frankfurt Stock Exchange) were analyzed to assess whether or not these securities were traded in those markets. The investigation shows that none of the convertible securities were traded on those exchanges and could not have made up for the potential excess volume that was not traded on the U.S. exchanges.

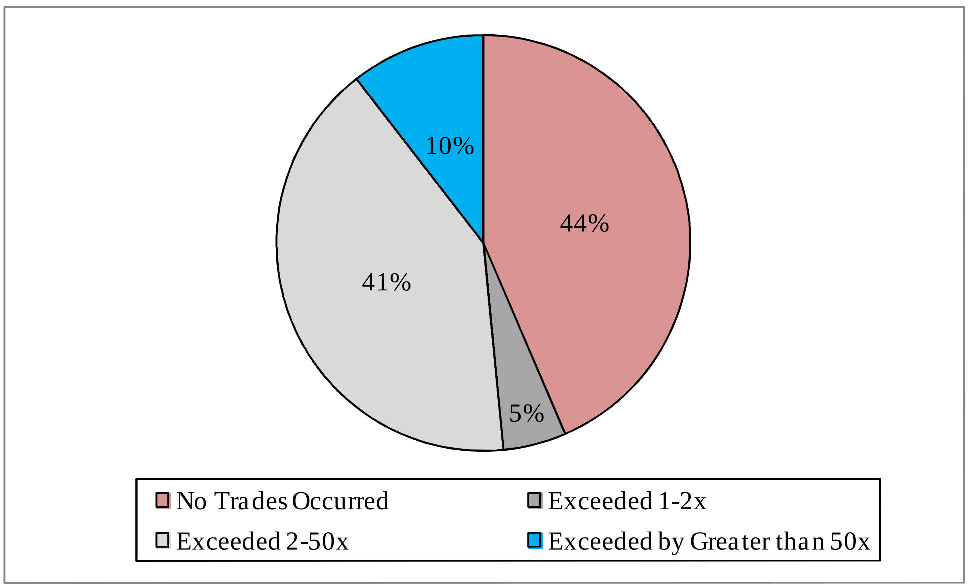
[81] This is the time period for which convertible arbitrage information was available for these accounts.

described above. 1,079 of the convertible securities in these eight accounts (over 90% of the total) exceeded the daily volume on the transaction day by an average of nearly 30 times the actual daily volume. Nearly forty percent of the trades occurred where there was no reported volume at all in that particular security for that particular day. In one instance, the volume reported by House 17 was over 500 times the total volume reported in the entire market.

78. Accordingly, the purported securities trades underlying the convertible arbitrage strategy for House 17 customers could not have been legitimate trades as they exceeded the reported volume of the entire market on the securities House 17 purportedly executed.

Figure 3

Breakdown of Purported Securities Exceeding Daily Volume for 8 A&B Accounts

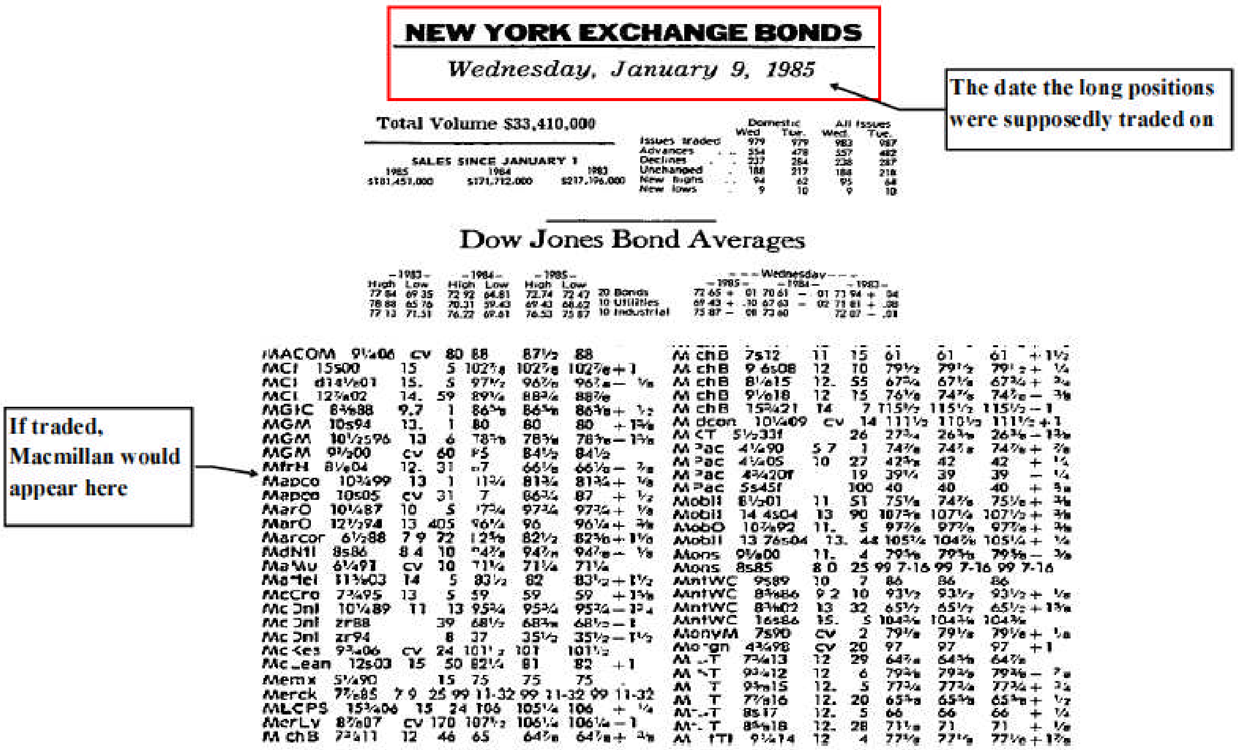


79. These volume discrepancies are further illustrated with an <u>individual transaction on a single customer ledger</u>. Referring to Table 2, on January 9, 1985, the A&B customer statement states that $1,411,000 par amount of Macmillan, Inc. subordinate debt was traded (Row A and Row B). However, on that day, this security did not change hands in the open market (*see* Figure 4 below for listing of traded securities for January 9, 1985).[82] Accordingly,

[82] *New York Exchange Bonds Daily Records*, Wall St.J.,Jan. 9, 1985.

House 17 simply could not have legitimately traded Macmillan, Inc. subordinate debt on that day.[83]

Figure 4



(iii) Purported purchase prices of convertible securities on customer accounts did not represent true prices.

80. The purchase prices for the convertible securities as stated on the House 17 customer ledgers were tested against the historical market prices to determine if the purported House 17 trades fell within the actual daily market trading range. As House 17 often purportedly executed the same security several times per day for the accounts, each unique trade price was tested against the historical trading range for that day. For the months, October 1979, November

[83] The Macmillan Inc. subordinated debt could not have traded on the OTC market either. While the New York Exchange Bonds listing does not reflect OTC trading, the S&P Bond Guide captures the month-end high and low traded prices for the <u>exchanges and the OTC market</u>. A review of the February 1985 S&P Bond Guide as of month-end January 1985 for the <u>exchanges and the OTC market</u> indicates that the high traded price for the MacMillan subordinated debt in January 1985 was $154 and the low was $141.5. Given that the House 17 customer statements indicate a traded price of $138 as of January 9, 1985, this price is outside the possible traded range in both the exchanges and OTC market and could not have been traded in either market. S&P Bond Guide, February 1985, p. 10.

1979 and March 1981, 166 unique trade prices were tested.[84] Of the 166 unique trade prices, 126, or 76 percent, were outside the actual daily market trading price range showing that the prices listed on the customer statements were fictitious.[85]

81. The pricing discrepancies were further tested during the A&B Time Period for the eight A&B accounts to determine if the same anomalies described above occurred throughout the timeframe during which House 17 was purportedly implementing a convertible arbitrage strategy for these accounts. Of the 1,127 securities with unique prices that were tested, 857, or 76 percent, were outside the actual reported daily market price range.

82. This pricing issue is further illustrated earlier in Table 2 with the Macmillan, Inc. sub-debt long position. The statement shows that $1,411,000 par value of the Macmillan convertible bond was traded on January 9, 1985 at a price of $138 (Row A and Row B). However, given that there was no trading of the bond on this date; House 17 could not have purchased the Macmillan, Inc. sub-debt for $138.[86]

(iv) Convertible securities continued to be purportedly traded by House 17 even after they were called for conversion.

83. Many convertible securities have the option for the company to call the security at a predetermined date or at the company's discretion. That is, the company has the right to convert the convertible securities into common shares. In instances where the bond or preferred equity is called, the shares are converted on the record date at a determined amount. Once the security is converted by the company it can no longer be held by an investor. However, there are several instances where customer statements show that a convertible

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[84] In some instances historical data was unavailable. In the case of the Over-the-Counter ("OTC") transactions, the only publicly available information was the bid-ask and close prices. Therefore, no conclusive range could be determined.

[85] In those cases where the purported House 17 trades were higher or lower than the actual recorded daily market traded prices, the House 17 prices themselves would have been the daily high or low. In the event that the out of range prices on the House 17 customer statements were the result of an inadvertent typing error (sometimes referred to as "fat fingering"), House 17 would have had to issue corrected trade confirmations and customer statements with actual market prices. There is no evidence of any corrections or reissuance to account for these corrections.

[86] *New York Exchange Bonds Daily Records*, Wall St. J., Jan. 9, 1985.

arbitrage transaction was purportedly still being held by a House 17 customer despite the fact that the security had already been called.

84. In the case of Macmillan, Inc., Table 2 the subordinated debentures were converted into 1,645,071 shares of common stock in January 1985, however House 17 purportedly closed out its position on March 14, 1985 (Row H).[87] This transaction simply could not have been legitimately completed as depicted on the customer statement given that the debentures were retired by MacMillian, Inc. well before the March 14, 1985 date that House 17 purports to convert the convertible security and buy back the common shares.

(v) House 17 did not account for dividend payments or accrued interest on the convertible bonds thereby evidencing the fictitious nature of the underlying transactions.

85. One major component of a convertible arbitrage transaction is that the underlying convertible security pays a regular coupon or dividend. This additional income impacts how the transaction is executed as the coupon or dividend is considered in the valuation of the underlying security, which is used to determine whether an arbitrage situation exists. In many instances, however, House 17 did not account for the coupon or dividend payment during the purported convertible arbitrage transactions.

86. An analysis was performed to identify actual dividend or coupon payments for those convertible securities in which House 17 customers were purportedly invested as of the ex-dividend date. The dates and amounts were then reconciled to the customer ledgers to confirm whether or not House 17 accurately recorded these payments. In many instances, the coupon or dividend payments were not recorded as being paid to the customer.

87. For example, Textron Inc. Preferred Convertible security paid a dividend of $0.52/share to record holders as of June 15, 1982 (*see* Figure 5).[88] A&B account A10045 was an account holder as of this record date and should have received a dividend payment worth $6,592.56 (12,678 shares times $0.52/share). However, this payment does not appear on the A&B account 1A0045 ledger.

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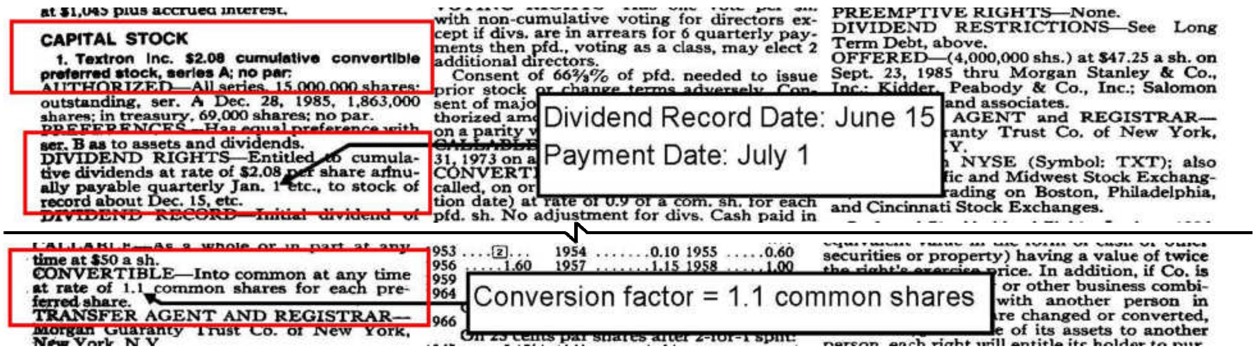
[87] MacMillan, Inc. at 4079, *Moody's Industrial Manual,* (1985).
[88] Textron Inc. at 3553, *Moody's Industrial Manual* (1985).

Figure 5



88. Based upon the foregoing discussion regarding dividend discrepancies, this investigation and analysis shows that trading in House 17 did not occur.

(vi) There is no evidence that House 17 converted the convertible securities into common shares.

89. Companies that have publicly traded securities typically use third-party institutions known as transfer agents to keep track of the individuals and entities that own their stocks and bonds. Most transfer agents are banks or trust companies, but sometimes a company acts as its own transfer agent.[89] Companies that issue preferred convertible stock and convertible subordinated debt must do so through these transfer or conversion agents.

90. The transfer agent maintains records of pertinent shareholder information, such as names, addresses and number of shares owned. The transfer agent also administers dividend payments for companies, including dividends to be paid to each shareholder and making dividend distributions by mailing out dividend checks or through other means.[90]

91. Given these agents stand directly between the issuing company and the security holder, operations with these agents would have been essential to carrying out House 17's purported convertible arbitrage strategy. The Securities and Exchange Act of 1934 requires that transfer agents be registered with the SEC, or if the transfer agent is a bank, with a bank regulatory agency.[91] As a result, the SEC has strict rules and regulations in place for all registered

[89] *See* Transfer Agents, U.S. Securities and Exchange Commission (11/20/11), http://www.sec.gov/answers/transferagent.htm.
[90] *Id.*
[91] The Securities Exchange Act § 17A(c), 15 U.S.C. §78 (2010).

transfer agents that include minimum performance standards regarding the issuance of new certificates and related recordkeeping.

92. In order to convert shares of preferred convertible stock or convertible subordinated debt into common stock, shareholders must contact the company's transfer agent and complete the following:

- Complete and sign a conversion notice provided by a conversion agent, and deliver such notice to the conversion agent;
- Deliver a certificate or certificates representing the shares of convertible preferred stock/subordinated debt to be converted to the conversion agent; and
- If required, furnish appropriate endorsements and transfer documents.[92]

93. In order to have converted preferred convertible stock and convertible debt into common stock, House 17 would have needed documentation from any entity that could convert the shares and successfully execute the purported convertible arbitrage strategy. To test whether proper documentation existed, ten purportedly converted securities were tested for proper documentation as shown in Table 3.[93]

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[92] Such documentation usually contains most, if not all, of the following information: conversion date, conversion factor (shares or price), total principal amount, total number of shares, name(s) and address(es) of person(s) in whose name(s) the shares required to be delivered on conversion of the shares are to be registered.

[93] Data obtained from *Moody's Industrial Manual* for each of the respective years indicated in the table. The transfer agent for each company is listed by year; data was reviewed for the year in which conversion occurred. Aetna Life at 4303, *Moody's Bank & Finance Manual* (1980); Reliance Group Inc. at 2478, *Moody's Bank & Finance Manual* (1980);Eaton Corp. at 296, *Moody's Industrial Manual* (1984); GATX Corp. at 1156, *Moody's Industrial Manual* (1980); Lear Siegler at 384, *Moody's Industrial Manual* (1978); Liberty National Corp. at 1493, *Moody's Bank & Finance Manual* (1981); TenneCo Corp. at 3143, *Moody's Industrial Manual* (1979); Texas Gas Transmission Corp., *Moody's Public Utility Manual* (1979); Trane Co. at 6053, *Moody's Industrial Manual* (1982); TRW Inc. at 4518, *Moody's Industrial Manual* (1982).

Table 3

Transfer Agents as of Conversion Date

Security	Date of Purported Conversion	Transfer Agents for Date of Purported Transaction
AETNA LIFE & CAS CO PDF CONV $2	8/22/1980	Hartford National Bank & Trust Morgan Guaranty Trust
RELIANCE GROUP INC PFD SER B CONV $2.20	7/25/1979	First Jersey National Bank Jersey City
EATON CORP PFD SER B CONV $10	3/13/1984	AmeriTrust Co., Cleveland
GATX CORP PFD CONV $2.50	6/3/1980	Manufacturers Hanover Trust
LEAR SIEGER INC PFD CONV $2.25	1/10/1979	Irving Trust Co. United California Bank
LIBERTY NATL CORP PFD CONV $2.125	7/13/1981	Liberty National Bank & Trust
TENNECO CORP PFD $1.60	10/24/1979	Chemical Bank
TEXAS GAS TRANSMISSION CORP PREF CONV $1.50	12/12/1979	Chemical Bank
TRANE CO SUB DEB CONV 4.000 9/15/1992	9/23/1982	Morgan Guaranty Trust
TRW INC PREF SER 1 CONV $4.40	12/11/1981	Morgan Guaranty Trust

94. No relevant documentation related to transfer agents or the conversion of any of the underlying convertible securities was identified. Absent this documentation and communication with the transfer agents, House 17 could not have converted the underlying shares into common stock for any of the thousands of transactions in its convertible arbitrage strategy.

95. Further, House 17 did not consistently report on the customer statements that it had converted the convertible securities into the required number of common shares based on the correct conversion factor. For example, Coopers Industry Inc. Preferred Security B was purportedly traded by House 17 on May 19, 1980. The adjusted conversion factor at this time was 7.2 common shares per convertible security; the adjustment was effective as of April 1980 due to a 2-for-1 stock split (i.e., prior to April 1980, the conversion factor was 3.6). House 17,

however, did not account for the stock split and continued to use the unadjusted conversion factor of 3.6 shares. As a result, House 17 customers who owned Coopers Industry Inc. Preferred Security B during this time period received half the common shares they were purportedly owed when the convertible security was converted to common shares in July 1980. As shown below, the House 17 customers received 12,938 common shares when they should have received 25,876 shares based on the adjusted conversion factor.

Figure 6

7/31/80 AVELLINO & BIENES
285 MADISON AVENUE
NEW YORK NY 10017
1-00121-1-0

					6.250 4/01/1995			
7/14	7/21	2811		31	CONOCO INC PFD CONV $2	143	1/2	403.378.50
7/21	7/21		3594		COOPER INDS INC PFD SER B CONV $2.50	DELV		
7/21	7/21	12938			COOPER IND INC	RECD		
7/21	7/21		11623		PETROLEUM & RESOURCES PFD PFD CONV	DELV		

MF00084918

Figure 7

CAPITAL STOCK

1. Cooper Industries, Inc. $2.50 cumulative convertible preferred, series B; no par:

AUTH.—All series, 1,811,240 shs.; this series, 470,490 shs.; outstanding, Dec. 31, 1979, 42,469 shares; no par.
PREFERENCES—Has preference as to assets and divs.
DIV. RIGHTS—Entitled to cum. cash divs. of $2.50 annually, payable quarterly Mar. 31, etc.
DIVIDEND RECORD—Initial dividend of $0.4166 paid Dec. 31, 1972; regular dividends thereafter.
LIQUIDATION RIGHTS—In liquidation, entitled to $55 a sh. plus divs. if involuntary; if voluntary, redemption price.
VOTING RIGHTS—Same as series A pfd.
CALLABLE—During each 12 month period beginning Oct. 31, as follows:
1980 ......56.00 1981 ......55.50 1982 ......55.00
1983 ......54.50 1984 ......54.00 1985 ......53.50
1986 ......53.00
1987 and thereafter, 52.50
CONVERTIBLE—Into 7.2 com. shs. (adj. for 2-for-1 split Apr., 1980) at any time (if called, on or before redemption date); cash or scrip paid in lieu of fractional shs. Conversion privilege protected against dilution.
PREEMPTIVE RIGHTS—None.

periods shall have been declared and paid or funds therefor set apart and all accrued sinking fund obligations applicable thereto have been complied with. The affirmative vote of at least a ... voting separat... effect (i) the ... of all or subs... siness, or its c... o any other c... on resulting from such consolidation or merger will have after such consolidation or merger no class of shs. either authorized or outstg. ranking prior to or on a parity with the pfd. stock; or (ii) the authorization of any shs. ranking on a parity with the pfd. stock or an increase in authorized number of shs. of pfd. stock.
Whene... payment of ... pfd. stock, wh... the holders o... separately as ... ther rights to ... d to elect two members of the board of directors of Co. who will be in addition to the regular members of the board of directors elected by the holders of com. stock and directors elected by holders of any other class of shs.
CALLABLE—As a whole or in part at any time on at least 30 but not more than 60 days' notice beginning Oct. 1, 1984 to each Sept. 30

Dividend Payment Date: June 30

Conversion Factor= 7.2 common shares

96. Additionally, when the convertible security is converted into common stock, a fractional share often remains, as the number of shares-to-par value is not cleanly divisible by the conversion factor/price. For example, if the conversion factor on 100 convertible securities is 0.3 common shares, upon conversion the owner would receive 33 1/3 common shares. When

this occurs, the company will pay out the fractional share in cash <u>on the date of the conversion</u>. The payment value is the fraction of a share multiplied by the trading price for the common stock on the date converted.

97. In instances where fractional shares appear on the House 17 customer ledgers, they were not paid out at the price on the <u>conversion date,</u> which is required. For example, House 17 recorded a journal entry of $18.90 on May 7, 1982 for fractional shares of Textron Inc. (Row D in Table 4). This equates to a common share price of $23.63, multiplied by the fraction of a share left after converting 12,678 shares of Textron Preferred at the conversion factor of 1.1 shares of common/share of preferred. $23.63 was <u>not</u> the price of the common stock as of the conversion date. The value of the fractional share would not be known until the conversion date, which in this case was June 30, 1982 (Row E). On June 30, 1982, the common share price for Textron was $18.88, which, after converting at the conversion factor of 1.1 shares, would result in a fractional share payment of $15.10 not the $18.90 that House 17 recorded on May 7th (i.e., a difference of 25%).

Table 4

	Bates	Statement Date	Transaction Date	Long	Short	Security	Price	Debit	Credit
A	MF00147263	5/28/1982	29-Apr		7,065	TEXTRON INC	23 3/4		$ 167,793.75
B	MF00147263	5/28/1982	29-Apr		6,880	TEXTRON INC	23 7/8		164,260.00
C	MF00147263	5/28/1982	30-Apr	12,678		TEXTRON INC PFD CONV $2.08	25 1/8	$ 318,334.79	
D	MF00147263	5/28/1982	7-May			TEXTRON INC FRACTIONAL SHARES	JRNL		18.90
E	MF00147806	6/30/1982	30-Jun		12,678	TEXTRON INC PFD CONV $2.08	DELV		
F	MF00147806	6/30/1982	30-Jun	13,945		TEXTRON INC	RECD		
							Total	$ 318,334.79	$ 332,072.65

98. Based upon the foregoing discussion regarding House 17's incorrect conversion processes, this investigation and analysis show that trading in House 17 did not occur.

(vii) Fictitious Convertible Arbitrage Trade Confirmations

99. Upon close examination, trade confirmations fabricated by House 17 to support the convertible arbitrage trades were actually prepared backwards. A good exemplar of this was

a purported convertible trade executed for the account referenced in the customer statement Figure 8.[94]

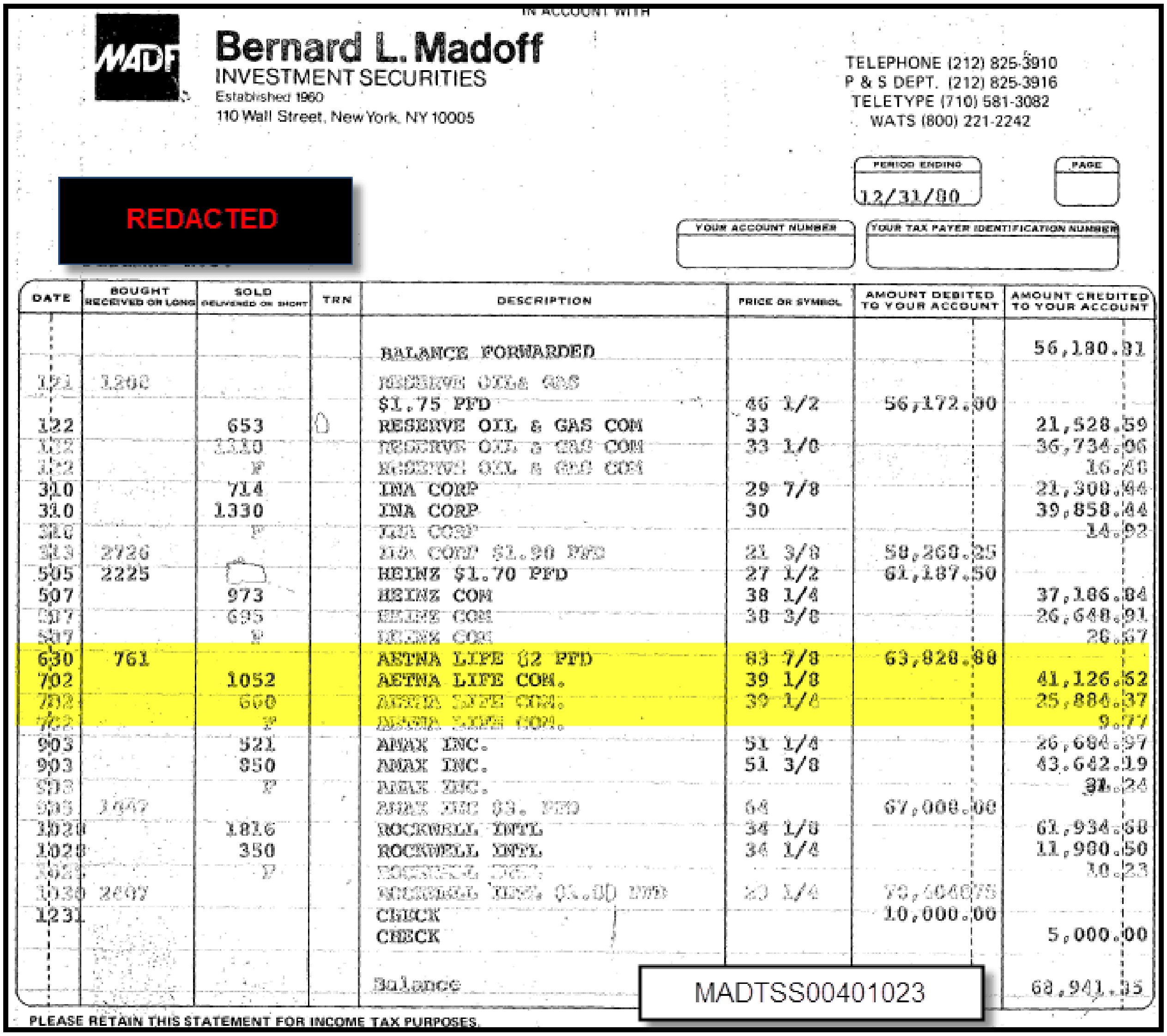
100. The purported convertible trade was as follows:

- A purchase of 761 shares of Aetna Life & Casualty $2 Pfd on 6/23/80, settlement on 6/30/80 at $83 7/8 per share. The shares had a conversion factor of 2.25.
- Two sales of Aetna Life & Casualty common stock; one for 1052 shares at $39 1/8 and one for 660 shares at $39 ¼.
- The purported trade was to be an eight week trade that was pre-calculated to generate $3,191 in total profits with a close out date of 9/1/80.[95]

[94] The customer name has been redacted.
[95] *See* Adding Machine Tape calculating projected profit on the purported trade. MADTS00401002. *See also,* MADTSS00400966 at MADTSS00400966 and MADTSS00401003 for handwritten notes detailing specifics of purported trade.

101. The year-end 12/31/80 customer statement for account holder Madoff-X1 shows the purported transaction as follows in Figure 8 below:

Figure 8



IN ACCOUNT WITH

Bernard L. Madoff
INVESTMENT SECURITIES
Established 1960
110 Wall Street, New York, NY 10005

TELEPHONE (212) 825-3910
P & S DEPT. (212) 825-3916
TELETYPE (710) 581-3082
WATS (800) 221-2242

REDACTED

PERIOD ENDING 12/31/80 | PAGE

YOUR ACCOUNT NUMBER | YOUR TAX PAYER IDENTIFICATION NUMBER

DATE	BOUGHT RECEIVED OR LONG	SOLD DELIVERED OR SHORT	TRN	DESCRIPTION	PRICE OR SYMBOL	AMOUNT DEBITED TO YOUR ACCOUNT	AMOUNT CREDITED TO YOUR ACCOUNT
				BALANCE FORWARDED			56,180.81
121	1200			RESERVE OIL& GAS $1.75 PFD	46 1/2	56,172.00	
122		653		RESERVE OIL & GAS COM	33		21,528.59
122		1110		RESERVE OIL & GAS COM	33 1/8		36,734.06
122		F		RESERVE OIL & GAS COM			16.48
310		714		INA CORP	29 7/8		21,308.44
310		1330		INA CORP	30		39,858.44
310		F		INA CORP			14.92
313	2726			INA CORP $1.90 PFD	21 3/8	58,268.25	
505	2225			HEINZ $1.70 PFD	27 1/2	61,187.50	
507		973		HEINZ COM	38 1/4		37,186.84
507		695		HEINZ COM	38 3/8		26,648.91
507		F		HEINZ COM			26.67
630	761			AETNA LIFE $2 PFD	83 7/8	63,828.88	
702		1052		AETNA LIFE COM.	39 1/8		41,126.52
702		660		AETNA LIFE COM.	39 1/4		25,884.37
702		F		AETNA LIFE COM.			9.77
903		521		AMAX INC.	51 1/4		26,684.97
903		850		AMAX INC.	51 3/8		43,642.19
903		F		AMAX INC.			31.24
903	1047			AMAX INC $3. PFD	64	67,008.00	
1028		1816		ROCKWELL INTL	34 1/8		61,934.68
1028		350		ROCKWELL INTL	34 1/4		11,980.50
1028		F		ROCKWELL INTL			10.23
1030	2607			ROCKWELL INTL [illegible] PFD	28 1/4	73,646.75	
1231				CHECK		10,000.00	
				CHECK			5,000.00
				Balance			68,941.35

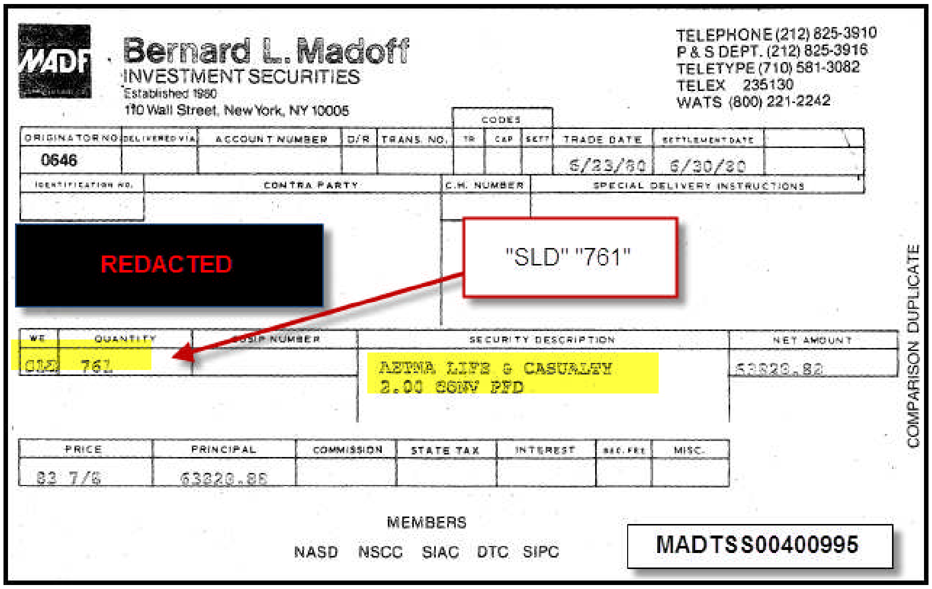
MADTSS00401023

PLEASE RETAIN THIS STATEMENT FOR INCOME TAX PURPOSES.

102. The customer statement shows the purported purchase of the Aetna Life Pfd and short sale of the Aetna Life common stock. However, the purported trade confirmations fabricated by House 17 show the opposite of what the purported trades were supposed to be. Shown below in Figure 9, Figure 10 and Figure 11, the trade confirmations show that the Aetna Life Pfd was <u>sold</u> rather than bought on 6/30 and that the Aetna common stock was bought on 7/2/80, clearly the direct opposite of what the customer statement was showing for the purported

trades.[96] The fictitious trade confirmations fabricated by House 17 for this example simply got it wrong.

Figure 9



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TELEX 235130
WATS (800) 221-2242

ORIGINATOR NO.	DELIVERED VIA	ACCOUNT NUMBER	D/R	TRANS. NO.	CODES TR	CAP	SETT	TRADE DATE	SETTLEMENT DATE
0646								6/23/80	6/30/80

IDENTIFICATION NO.	CONTRA PARTY	C.H. NUMBER	SPECIAL DELIVERY INSTRUCTIONS

REDACTED

"SLD" "761"

WE	QUANTITY	CUSIP NUMBER	SECURITY DESCRIPTION	NET AMOUNT
SLD	761		AETNA LIFE & CASUALTY 2.00 CONV PFD	63828.82

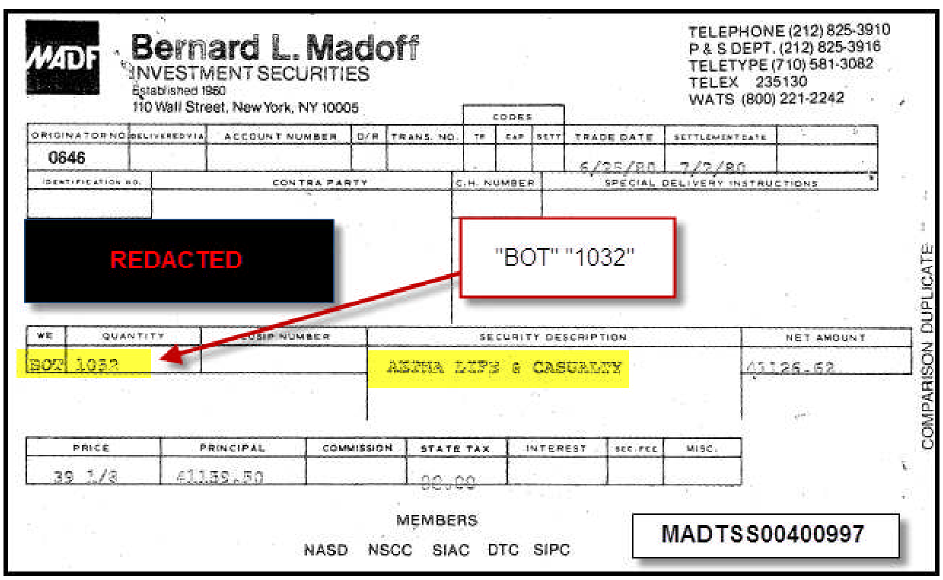
PRICE	PRINCIPAL	COMMISSION	STATE TAX	INTEREST	SEC. FEE	MISC.
83 7/8	63829.88					

MEMBERS
NASD NSCC SIAC DTC SIPC

COMPARISON DUPLICATE

MADTSS00400995

Figure 10



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TELEX 235130
WATS (800) 221-2242

ORIGINATOR NO.	DELIVERED VIA	ACCOUNT NUMBER	D/R	TRANS. NO.	CODES TR	CAP	SETT	TRADE DATE	SETTLEMENT DATE
0646								6/25/80	7/2/80

IDENTIFICATION NO.	CONTRA PARTY	C.H. NUMBER	SPECIAL DELIVERY INSTRUCTIONS

REDACTED

"BOT" "1032"

WE	QUANTITY	CUSIP NUMBER	SECURITY DESCRIPTION	NET AMOUNT
BOT	1032		AETNA LIFE & CASUALTY	41126.62

PRICE	PRINCIPAL	COMMISSION	STATE TAX	INTEREST	SEC. FEE	MISC.
39 7/8	41159.50		33.00			

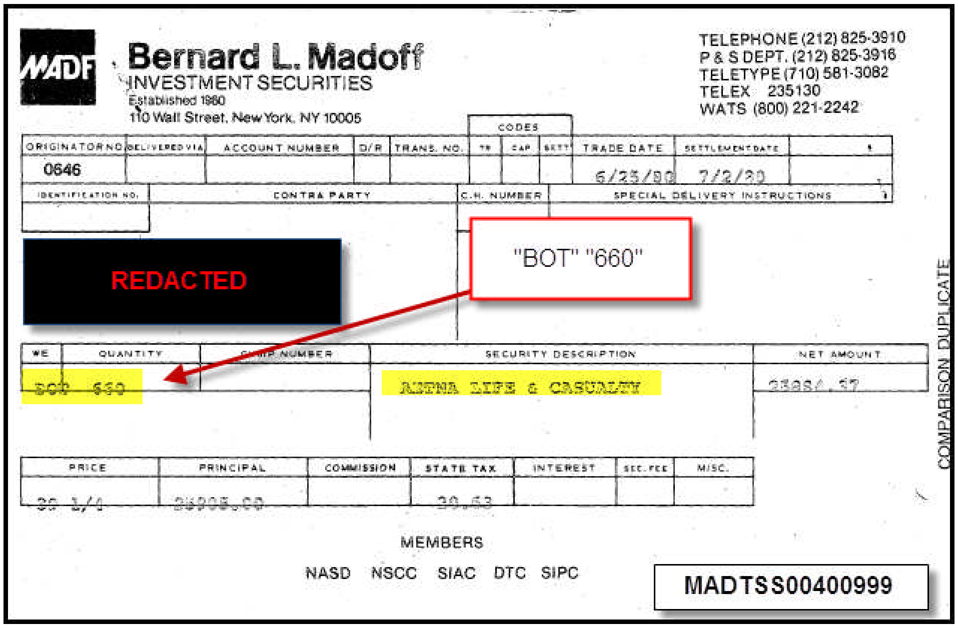
MEMBERS
NASD NSCC SIAC DTC SIPC

COMPARISON DUPLICATE

MADTSS00400997

[96] The customer statements showed only the settlement dates and not the trade dates. June 30, 1980 was the purported settlement date for the purported June 23, 1980 trade for Aetna Pfd.

Figure 11



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TELEX 235130
WATS (800) 221-2242

ORIGINATOR NO.	DELIVERED VIA	ACCOUNT NUMBER	D/R	TRANS. NO.	CODES TR	CAP	SETT	TRADE DATE	SETTLEMENT DATE
0646								6/25/80	7/2/80

IDENTIFICATION NO.	CONTRA PARTY	C.H. NUMBER	SPECIAL DELIVERY INSTRUCTIONS

REDACTED

"BOT" "660"

WE	QUANTITY	CUSIP NUMBER	SECURITY DESCRIPTION	NET AMOUNT
BOT	660		AETNA LIFE & CASUALTY	[illegible]

PRICE	PRINCIPAL	COMMISSION	STATE TAX	INTEREST	SEC. FEE	MISC.
39 1/4	25905.00		39.63			

MEMBERS
NASD NSCC SIAC DTC SIPC

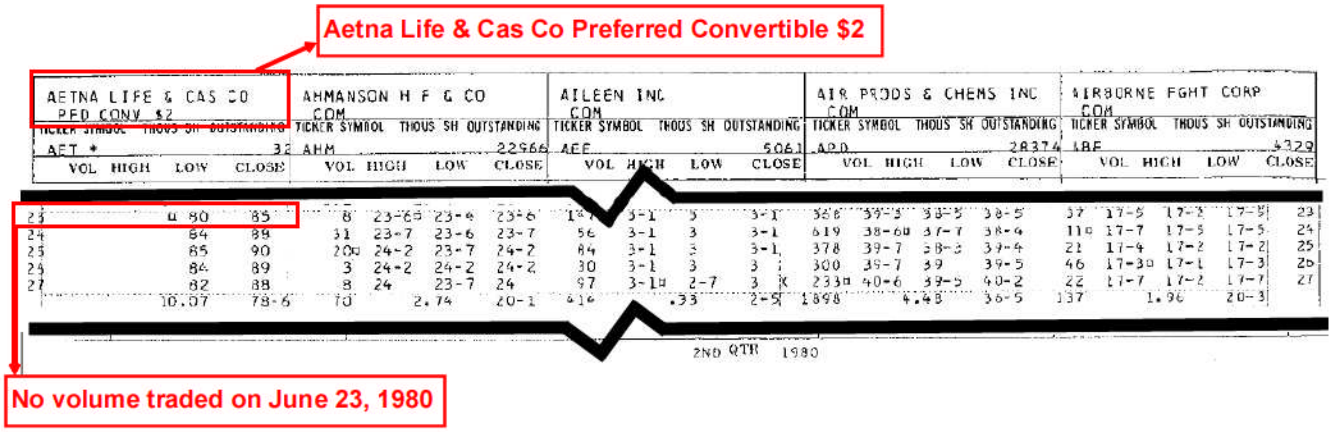
COMPARISON DUPLICATE

MADTSS00400999

103. The Aetna convertible arbitrage purported trade example discussed above suffers from other similar deficiencies for the convertible arbitrage examples discussed *supra* in this section. This investigation and analysis similarly support that convertible arbitrage trading in House 17 did not occur.

104. Most importantly, as shown on the trade confirmation (Figure 9), Madoff purportedly purchased 761 shares of Aetna Life $2 Pfd for $83.875 on June 23, 1980. However, according to the Daily Stock Price Record (Figure 12 below), this security did not change hands in the open market that day. Therefore, it would not have been possible for House 17 to legitimately trade Aetna Life $2 Pfd on that day.

Figure 12



b. **Following the 1992 SEC investigation of A&B, BLMIS purportedly transitioned from convertible arbitrage to the split strike conversion investment strategy.**

105. A&B was an accounting firm at its origin, but developed exclusively into a "private investing" firm in the mid-1980s given the investing business had increased in relative importance to the extent that it was "financially wise" to end the accounting practice.[97] A&B, however, was never registered as a broker dealer, an investment company, or an investment adviser.[98] As of 1992, A&B had three partners: Frank Avellino ("Avellino") was a 50% partner, Michael Bienes ("Bienes") and Dianne Bienes were each 25% partners.[99]

106. A&B first began investing with House 17 in the 1960s through its predecessor, Alpern & Avellino.[100] Saul Alpern was Madoff's father-in-law and founder of the accounting firm. A&B attracted investor funds by promising guaranteed rates of return (typically 13%-18%)

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[97] Avellino and Bienes Dep. Ex. 02901-02902, July 7, 1992.
[98] Avellino and Bienes Dep. July 7, 1992. MADOFF_EXHIBITS-03014
[99] Avellino & Bienes Agreement of General Partnership (executed Aug. 12, 1988). MBISAA0003076, 3079
[100] *SEC v. Avellino & Bienes, et al*, No. 92-CV-08314 (JES), Complaint for Preliminary and Permanent Injunctive and Other Equitable Relief, ECF No. 4 (S.D.N.Y. Nov, 25, 1992).; Linda Sandler & Allan Dodds Frank, *Madoff's Tactics Date to 1960s When Father-In-Law Was Recruiter*, available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=at1ierlaVQyg (last visited Nov. 17, 2011).

on money collected from individuals and entities[101] and labeling the transactions with investors as "loans."[102] A&B issued letters to investors that specified the rate of return on these loans.[103] A&B in turn invested customer funds with BLMIS and retained the difference between the returns BLMIS promised to A&B and the returns A&B promised to its underlying investors.[104] At the time of the SEC's investigation in 1992, A&B was one of House 17's largest sources of investor monies, funneling hundreds of millions of dollars into House 17's investments through A&B.[105]

107. On November 17, 1992, the SEC filed a complaint against A&B and Avellino and Bienes individually, seeking, among other things, a permanent injunction for having unlawfully operated as an unregistered investment company.[106] Avellino and Bienes entered into a consent decree in which they agreed not to sell securities without a registration statement or acting as an investment company. In addition, they agreed pay fines to the SEC totaling $350,000.[107]

108. Prior to approximately June 23, 1992, A&B maintained IA accounts with House 17 with the following account numbers: 1A0045, 1A0046,[108] 1A0047, 1A0048, 1A0049 and 1A0050 (the "Existing A&B IA Accounts").[109] During that time, A&B used these House 17 accounts to invest money pooled from investors.[110] Prior to its creation as described below on or around June 23, 1992, A&B IA account number 1A0053 did not exist. Documents provided in

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[101] A&B Loans Detail by Investor. SECSDK0000325- SECSDK0000834; *SEC v. Avellino & Bienes, et al*, No. 92-CV-08314 (JES), Complaint for Preliminary and Permanent Injunctive and Other Equitable Relief, ECF No. 4 (S.D.N.Y. Nov, 25, 1992).
[102] *See, e.g.*, Avellino and Bienes Dep. Ex. 02913;02925-02934, July 7, 1992.
[103] *Avellino & Bienes, et al*, No. 92-CV-08314 (JES), Complaint for Preliminary and Permanent Injunctive and Other Equitable Relief, ECF No. 4 (S.D.N.Y. Nov, 25, 1992).
[104] Frontline Transcript of Interview of Michael Bienes, *available at* http://www.pbs.org/wgbh/pages/frontline/madoff/interviews/bienes.html (last visited Nov. 17, 2011); *SEC v. Avellino & Bienes, et al*, Complaint for Preliminary and Permanent Injunctive and Other Equitable Relief. MADOFF_EXHIBITS-03058
[105] BLMIS customer statements for A&B accounts through June 1992.
[106] *Avellino & Bienes, et al*, No. 92-CV-08314 (JES), Complaint for Preliminary and Permanent Injunctive and Other Equitable Relief, ECF No. 4 (S.D.N.Y. Nov, 25, 1992).
[107] *SEC v. Avellino & Bienes, et al*, No. 92-CV-08314 (JES), Final Judgment of Permanent Injunction and Other Equitable Relief and Consent Against Avellino & Bienes, Frank J. Avellino and Michael S. Bienes, ECF No. 3 (S.D.N.Y. Nov, 25, 1992).
[108] Account number 1A0046 was in the name of the A&B Pension Plan & Trust. *See* Account Maintenance File for 1A0046. AMF00309438-9450
[109] *See* Arbitrage Portfolio Transaction Reports (MF00545002-MF00545003); Portfolio Management Reports as of June 30, 1992. MF00011542-51; *See also* Avellino and Bienes Dep. Ex. 03223, Nov. 20, 1992.
[110] BLMIS customer statements for A&B accounts through June 1992; Avellino and Bienes Dep., Nov. 20, 1992.

connection with the SEC investigation of A&B indicated that as of June 18, 1992 A&B owed its investors almost $399,819,455 despite the fact that the purported aggregate equity balance of the Existing A&B IA Accounts only totaled approximately $364 million.[111] Thus, the aggregate total amount reflected in the Existing A&B IA Accounts was approximately $35.8 million less than A&B had represented to the SEC it owed to underlying investors. Avellino and Bienes had testified to the SEC that A&B utilized an account or accounts at Chemical Bank to handle investor funds and that the balance maintained in these account(s) was typically $2 million to $3 million but never higher than $6 million.[112] Assuming that the Chemical Bank Account held all $6 million, this meant that A&B had a funding shortfall of at least approximately $29.8 million ($399.8 million owed to investors less $364.0 million purported aggregate equity balance of the A&B accounts and less a maximum of $6 million that could be purportedly held at Chemical Bank at any time) in its House 17 accounts.[113]

109. The existence of this funding shortfall significantly contradicted sworn testimony by Avellino and Bienes provided to the SEC in which they claimed that A&B had a significant "cushion" between what it owed on "loans" from investors and what it held in capital in its accounts at BLMIS, which would protect customers from potential losses.[114] The shortfall explained above demonstrates that a cushion did not exist in June 1992. Therefore, around June 1992, House 17 created an additional account for A&B (the "1A0053 Account") and manufactured fictitious trading in this account in order to conceal the shortfall.[115] Backdated transactions manufactured in the 1A0053 Account were designed to show realized and unrealized gains from securities and options transactions totaling approximately $65.9 million, which satisfied the shortfall and provided some of the purported cushion.[116] However, there is no evidence

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[111] A&B Loans Detail by Investor. SECSDK0000325; Arbitrage Portfolio Transaction Reports. MF00545002-MF00545003; Portfolio Management Reports as of June 30, 1992. MF00011542-51

[112] Avellino and Bienes Dep. Ex. 02917-02918, July 7, 1992.

[113] A&B Loans Detail by Investor. SECSDK0000325; Arbitrage Portfolio Transaction Reports. MF00545002-MF00545003; Portfolio Management Reports as of June 30, 1992. MF00011542-51); Avellino and Bienes Dep. Ex. 02917-02918, July 7, 1992.

[114] Avellino and Bienes Dep. Ex. 02944-02951, July 7, 1992.

[115] 1A0053 Account June 30, 1992 statements. MADTBB02391076-02391078 and MADTBB02391007-02391017

[116] 1A0053 Account Nov. 1989 to Dec. 1992 statements. MADTBB02397292; MADTBB02397300; MADTBB02397304; MADTBB02391086; MADTBB02390998-2391007; MADTBB02391009; MADTBB02391011; MADTBB02391013; MADTBB02391015; MADTBB02391017; MADTBB02391076; MADTBB02391078; MADTBB003346469; SECSDK0010189; MADTBB03347804; MADTBB03346114;

that this balance was the result of deposits and investments of funds received by either A&B or by A&B clients.[117] Instead, House 17 created fictitious backdated transactions to make it appear that the account had equity sufficient to make up the shortfall.[118]

110. In addition, generally House 17 created new account numbers sequentially, based on the date on which they were opened (e.g., 1A0045, 1A0046, 1A0047, etc.). For example, account 1A0052 (opened for a different BLMIS customer), was created in May 1992 and the first transaction posted to the account was the purported purchase of S&P 100 options on May 1, 1992.[119] Account 1A0054 (opened for a different BLMIS customer) was created in September 1992, with the first transaction posted on September 22 for the purported purchase of McKesson Corp. convertible subordinated debt.[120] Chronologically, the 1A0053 Account would have been created after 1A0052 (May 1992) and before 1A0054 (September 1992), and the 1A0053 Account therefore should not have reflected any transactions as occurring in 1989, 1990, 1991 or at any time prior to its creation in June 1992. However, the account statements generated for the 1A0053 Account reflected backdated transactions as early as November 1989.[121] The out of order sequencing of the account creation dates, as well as the backdated trades on the June 1992 customer statement, support that the 1A0053 account was fabricated by House 17 specifically in response to the SEC investigation (s*ee* Figure 13).[122]

MADTBB03345819-5823; MADTBB02391071; MADTBB03345824; MADTBB03345825-5830; MADTBB03345817-5818; SECSDK0000035; MADTBB03345466-5467; SECSDK0000141, 143-149; MADTBB03345474-5475; MADTBB03345492; MADTBB03345476-5484; MADTBB03347613-7614; MADTBB03345495-5496; MADTBB03345485-5487; MADTBB03345497-5503; MADTBB03347604-7605; MADTBB03345504; MADTBB03114024; MADTBB03114026

[117] 1A0053 Account June 30, 1992 statements. MADTBB02391076—02391078 and MADTBB02391007-02391017

[118] 1A0053 Account June 30, 1992 statements. MADTBB02391076—02391078 and MADTBB02391007-02391017

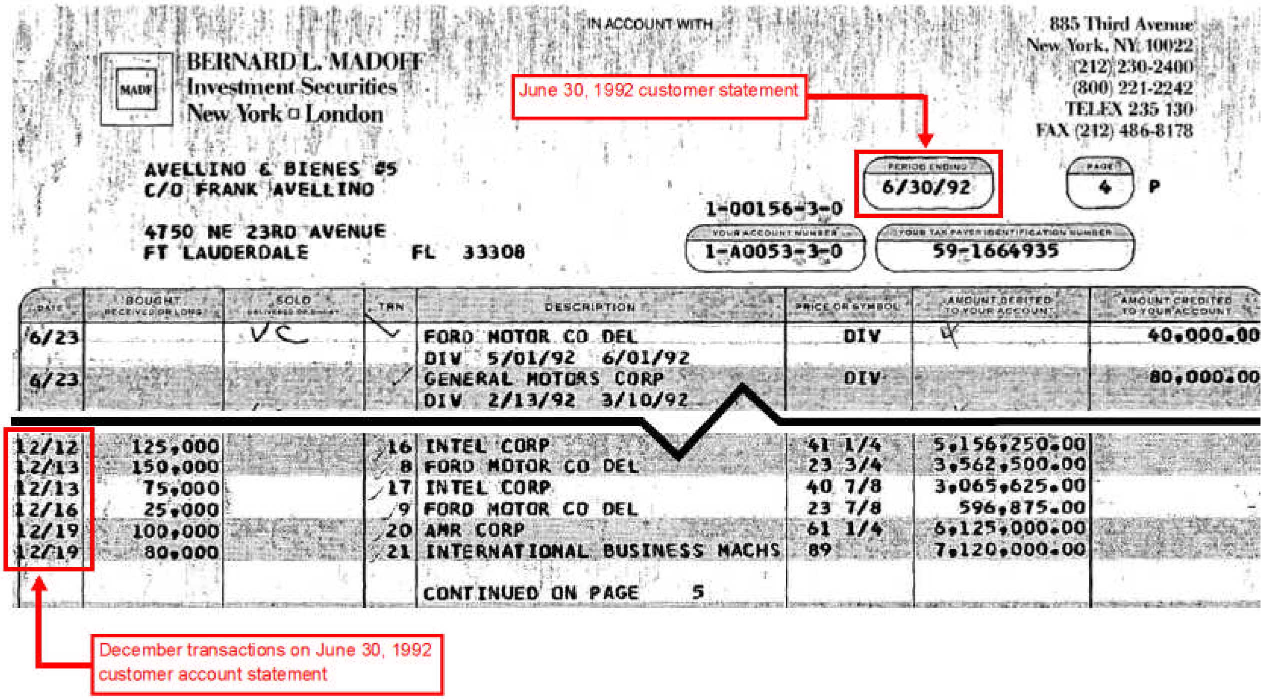
[119] *See* 1A0052 account May 31, 1992 statement. MF00462572

[120] *See* 1A0054 account September 30, 1992. MF00454666

[121] 1A0053 Account Nov. 1989 statement. MADTBB03346469

[122] It is worth noting that the Transaction IDs ("TRN" column) for the various transactions on this customer statement are out of sequence with the reported dates of the transactions. *See* MADTBB02391013

Figure 13

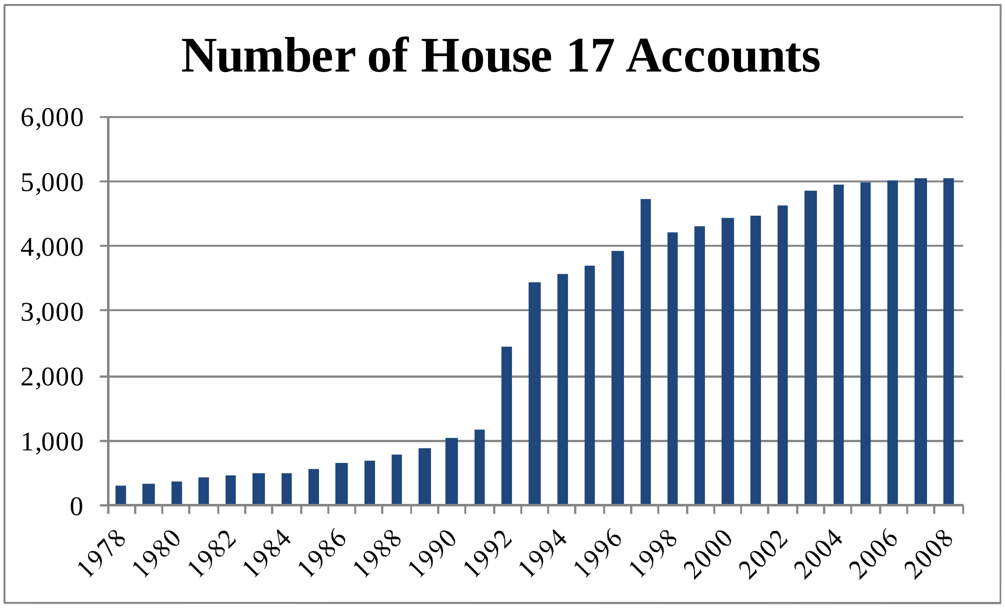


DATE	BOUGHT RECEIVED OR LONG	SOLD DELIVERED OR SHORT	TRN	DESCRIPTION	PRICE OR SYMBOL	AMOUNT DEBITED TO YOUR ACCOUNT	AMOUNT CREDITED TO YOUR ACCOUNT
6/23				FORD MOTOR CO DEL DIV 5/01/92 6/01/92	DIV		40,000.00
6/23				GENERAL MOTORS CORP DIV 2/13/92 3/10/92	DIV		80,000.00
12/12	125,000		16	INTEL CORP	41 1/4	5,156,250.00	
12/13	150,000		8	FORD MOTOR CO DEL	23 3/4	3,562,500.00	
12/13	75,000		17	INTEL CORP	40 7/8	3,065,625.00	
12/16	25,000		9	FORD MOTOR CO DEL	23 7/8	596,875.00	
12/19	100,000		20	AMR CORP	61 1/4	6,125,000.00	
12/19	80,000		21	INTERNATIONAL BUSINESS MACHS	89	7,120,000.00	
				CONTINUED ON PAGE 5			

111. After the liquidation of A&B, many of its former investors reinvested their returned funds directly with BLMIS, leading to a great influx of new BLMIS accounts.[123] (*See* Figure 14 below which highlights the dramatic increase in House 17 customer accounts after the liquidation of A&B in 1992). With the advent of these new accounts, House 17 implemented a new investment strategy.

[123] Portfolio Netcap Totals by Group-A&B dated March 31, 1993. MADTBB03079814-9910

Figure 14



c. The Split Strike Conversion Strategy- the 1990s and later: There is no evidence that the transactions purporting to represent a split strike conversion strategy for House 17 customers ever occurred. In fact, the evidence shows that these transactions were fictitious.

112. In the early 1990s, House 17 changed its primary purported investment strategy from convertible arbitrage to a split strike conversion strategy, stating that "the opportunity within the marketplace to trade convertible arbitrage has decreased."[124] A Split Strike Conversion ("SSC") investment strategy typically involves the buying of a basket of stocks closely correlated to an index, while concurrently selling call options on the index and buying put options on the index. House 17 purportedly used a SSC strategy that was purchasing a basket of stocks and options based on the S&P 100 equity index, which included the 100 largest U.S. stocks as determined by the S&P Index Committee.[125]

113. The SSC strategy, in proper use, reduces a portfolio's volatility (and risk) by limiting the investor's gains and losses that are possible. This is commonly referred to as a "collar

[124] Bernard Madoff, "Letter to Client." March 16, 1999. AMF00139075; *See also*, Trading Authorization Guidelines July 3, 1991. AMF00139560
[125] Michael Ocrant, *Madoff Tops Charts; Skeptics Ask How* at 1, 89 MAR/Hedge, May 2001. *See also*, http://www.standardandpoors.com/indices/sp-100/en/us/?indexId=spusa-100-usduf--p-us-l--

strategy," where the investor purchases a put option to provide protection on the downside (i.e., limiting losses the investor would incur if the market value of the equity portfolio drops); this protection is partially paid for by selling a call option that limits the upside gain.

114. While the collar strategy of SSC will limit volatility, it will not eliminate volatility entirely. In fact, a properly designed and executed SSC strategy would trade with the same volatility as the S&P 100 index when the market value of the equity portfolio fell between the exercise prices of the options.

(i) Purported equity and option trades exceeded the entire reported market volume for certain days.

115. Over the period January 2000 through November 2008 (the "Analyzed Time Period"), there were 105 days when House 17 transacted in equities above the market volume in the exchanges as reported by Bloomberg. In total, over those days, there were 912 instances when House 17 purported stock transactions exceeded the overall market volume for the day.[126]

116. For the Analyzed Time Period, House 17 traded 378 unique call options in 1,385 unique transactions. Of these purported call transactions, 64.4 percent of the contracts traded above the daily market volume, including 56.4 percent of transactions with purported volume occurring at 10 times above the daily market volume.

(ii) Hundreds of thousands of purported House 17 trades, affecting over 5,500 accounts, were priced outside the trading day's price range evidencing that they could not have been executed.

117. During the Analyzed Time Period, 99,972 equity transactions were purportedly traded outside of the daily market traded price range, across 5,328 House 17 customer accounts.[127] These purported transactions were derived from 496 unique transactions, 321 of which, based on what was recorded on House 17 customer statements, traded above the daily high price and 175 of which traded below the daily low price. The purported prices for these transactions exceeded the daily high by as much as $8.96 and were below the daily low by as much as

[126] An analysis was also performed on the Frankfurt and London Stock Exchanges for these securities. The analysis confirms that for those securities that were traded on these exchanges, the House 17 purported volume exceeded the aggregate historical daily volume for the U.S., London Stock Exchange and Frankfurt Stock Exchange.
[127] This time period was chosen based on the available trade data in the Settled Cash database (see description *supra*).

$105.04. On average, the purported transactions exceeded the daily high by $1.00 and were below the daily low by $2.39.

118. Equity trades, such as the purported transactions recorded by BLMIS on House 17 customer records, that would have been reported as having been executed outside the daily price range of the entire U.S. equities market could not have occurred. The data used in this analysis was obtained from Bloomberg, which receives its data directly from the exchanges and the over-the-counter markets. In the event that the out of range prices on the House 17 customer statements were the result of an inadvertent typing error (sometimes referred to as "fat fingering"), House 17 would have had to issue corrections with the appropriate prices.[128] There is no evidence of any corrections or reissuance. And more importantly, for the period during which DTC records are available, there are no DTC records evidencing these purported trades.

119. In addition to the equity transactions discussed above, thousands of purported option trades were examined and these also traded outside of the daily price range. During the Analyzed Time Period, 34,501 options transactions traded outside of the daily price range, across 5,271 customer accounts. Of the 49 unique options traded, 25 were traded above the daily high price and 24 were traded below the daily low price.

120. Options traded above the high price by as much as $15.25 higher and at an average of $2.17 above the high. Options traded below the daily low by as much as $6.05 lower and at an average of $1.48 below the low.

121. Similar to the equity trades discussed above, the purported options transactions recorded by BLMIS on House 17 customer records would have been reported as having been executed outside the daily price range of the entire U.S. options market and could not have occurred.

[128] National Securities Clearing Corporation- Rules and Procedures, page 51, October 11, 2011. As the BLMIS Training Manual itself states, "An investor can sell a security from a long position at any price as long as a buyer can be found;" as there would have been no buyer on the other side of these trades, these transactions could not have been executed. BLMIS Trading Manual. MMAD-BR00021287.

The data used in this analysis was obtained from the Chicago Board of Options Exchange ("CBOE").[129]

122. Based upon the foregoing discussion regarding pricing discrepancies, this investigation and analysis show that the SSC trading in House 17 did not occur.

(iii) House 17 purportedly bought low 83% of the time and sold high 72% of the time (VWAP Trades) evidencing the fictitious nature of the trades.

123. VWAP, or Volume-Weighted Average Price, is exactly what it sounds like: the average price weighted by total volume. VWAP equals the dollar value of all trading periods divided by the total trading volume for the current day. The formula is as follows:

$$P_{vwap} = \frac{\sum_j P_j * Q_j}{\sum_j Q_j}$$

P_{vwap}= Volume Weighted Average Price

P_j= price of trade j

Q_j= quantity of trade j

j= each individual trade that takes place over the defined period of time, excluding cross trades and basket cross trades

124. Calculation starts when trading opens and ends when trading closes. This is a common way to summarize the price of a stock on a given day. For example, some brokers will accept an order where the client gets a price based on the VWAP. Also, some institutions grade their traders by comparing the trader's performance to the VWAP. The VWAP has become more important recently because of its use in algorithmic trading. The theory is that if the price of a buy trade is lower than the VWAP, it is a good trade. The opposite is true if the price is higher than the VWAP.

[129] The S&P 100 Index options (OEX), which were purportedly traded by House 17, were traded exclusively on the CBOE. *OEX & XEO S&P 100 Index Options, A Discussion on the Benefits and Uses of the First Listed Index Option* at http://www.cboe.com/LearnCenter/pdf/OEX_12-05-01.pdf. (last visited November 18, 2011)

125. Another trading anomaly stemming from the purported SSC strategy in House 17 was how frequently House 17 reported that they purchased or sold equity at extremely favorable prices. A comparison of trading records for House 17 accounts against the market derived VWAP for the respective stocks over the Analyzed Time Period indicates that approximately 83 percent of the buy transactions by share volume were executed below the VWAP while 72 percent of the sell transactions by share volume were executed above the VWAP.

126. Given that House 17 was consistently outperforming VWAP, two observations can be made. First, assuming the purported trades had actually been placed, the ability to consistently obtain significant positive variance to VWAP on both the buy side and sell side of the trades would be indicia of potential front-running by House 17.

127. Alternatively, if House 17 was not front-running (which it was not), then the statistics of the purported House 17 trades showing that they were consistently beating VWAP by a wide margin is further evidence of the fictitious nature of the trades. A comparison of the purchase and sale of the same stock being actually traded by House 5 on the same day makes this clear.[130] The VWAP on those trades was consistently at or near VWAP, a finding that one would expect to see if algorithmic trading was actually being utilized.

(iv) Thousands of purported securities, affecting over 3,700 accounts, were recorded by House 17 as having settled on weekends or holidays when the exchanges are closed.

128. During the Analyzed Time Period, 7,736 trades were recorded as having settled on weekend days in 3,743 House 17 accounts. Given that the markets were closed on each of the 27 dates identified as weekend days on the customer statements, these settlements were not possible. On Saturday, January 8, 2000 alone, 3,732 of the approximately 4,215 House 17 accounts showed 7,464 trade settlements. These trades could not have settled on a Saturday, further evidencing that the trades in House 17 did not occur.

129. During the Analyzed Time Period, House 17 customer statements show 37 trades settled on recognized market holidays. Specifically, seven trades settled on September 4, 2000 and September 1, 2008, both of which fell on Labor Day in their respective years. On February

[130] For the Analyzed Time Period, approximately 51% of buy transactions executed out of House 5 were below the VWAP versus 82% in House 17; approximately 48% of sell transactions executed out of House 5 were above the VWAP versus 75% for House 17.

17, 2003, Washington's Birthday, one trade settled. On Memorial Day, May, 31, 2004, two trades settled. 27 trades settled on June 11, 2004, the Presidential funeral of Ronald Reagan, when the market was closed, once again evidencing that the trades in House 17 did not occur.[131]

(v) Thousands of purported House 17 split strike conversion equity and option trades, affecting nearly 6,000 accounts, were recorded as having settled on days not within the standard settlement duration timeframe.

130. For equity transactions, the industry requirement for settlement is three days after the trade date ("T+3").[132] Firms found to be in violation of the settlement timing requirements are subject to discipline by the DTC and NSCC, including expulsion, suspension or other limitations of trading, as well as potential fines, interest expense or other penalties.[133] The customer statements generated by House 17 show equity transactions clearing outside the T+3 industry standard for a number of customer accounts. 340,774 trades were recorded as having settled outside the industry required timeframes of the T+3 industry norm. Of these trades, 338,431, or 99.3 percent, settled four days after the trade date ("T+4"), which not only does not comply with standard trading practices, but would have resulted in the disciplinary actions described above by DTC and NSCC. For a number of accounts nearly 100 percent of trades in these accounts were settled outside the T+3 standard.

131. Similarly, with regard to purported option trades, a high percentage of option transactions were recorded as having settled in a timeframe outside the industry norms, which for options is trade date plus one day ("T+1").[134] House 17 statements regularly showed option transactions clearing outside the T+1 industry norm for a number accounts. During the Analyzed Time Period, House 17 customer statements show 546,999 option trades settling outside the T+1 industry norm. Of these trades, 539,449 or 98.6 percent, settled two days

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[131] *New York Stock Exchange Special Closings*, New York Stock Exchange (last visited 11/14/11), http://www.nyse.com/pdfs/presidents_closings.pdf (last visited 11/14/11).

[132] FINRA Notice 95-26, *Conversion To T+3 Settlement, Reg. T, And SEC Rule 15c3-3(m), And Ex-Dividend Schedule* (April 1995).

[133] *Rules, By-Laws, and Organization Certificate of the Depository Trust Company* at 61-62 (June 2011); *National Securities Clearing Corporation*, *Rules and Procedures* at 62 (Effective October 21, 2011).

[134] *See Index Options Product Specifications*, The Options Clearing Corporations(last visited Nov. 18, 2011), http://www.optionsclearing.com/clearing/clearing-services/specifications-index-options.jsp.

after the trade date (T+1), which does not comply with standard trading practices. These non-standard trade settlements further confirm that trading in House 17 did not occur.

d. There are no legitimate records from the DTC (or other clearing houses or custodians) evidencing any trades occurring from House 17.[135]

132. The Depository Trust & Clearing Corporation ("DTCC") was formed in 1999 by combining the DTC and the National Securities Clearing Corporation ("NSCC").[136] The DTCC, through its subsidiaries, provides clearance and settlement for almost all equity, bond, government securities, mortgage-backed securities, money market instruments and over-the-counter derivative transactions in the U.S. market.[137] Therefore, for any of these types of trades to occur in the U.S., the individual securities transaction must be routed through the DTCC before it can be finalized.

133. Transfers of securities between licensed brokers are conducted by the DTC through automated book-entry changes to the broker's accounts. Instead of trading paper stock certificates, as was the case in the early years of the trading markets, brokers make trades on a computer and the DTC keeps an electronic record of these transactions. A broker's account at the DTC shows the number of each security owned by that broker and a history of trades.[138]

134. The NSCC, originally created in 1976 before it merged into the DTCC in 1999, provides clearance and settlement services of equity, bond, exchange traded funds and unit investment trust transactions.[139] The NSCC acts as an intermediary between an exchange market (such as

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[135] Our search through over 28 million electronic records as well as over 11,000 boxes of hard copy documents did not reveal any evidence that the equity trades purportedly executed on behalf of House 17's customers ever occurred. *See* discussion *infra* regarding other analysis dating back to the 1970s which supports this finding.

[136] *About DTCC: History* (The Depository Trust & Clearing Corporation) at 17(Aug. 17, 2011). *See also*, *Responding to Wall Street's Paperwork Crisis*, The Depository Trust & Clearing Corporation (last visited Nov. 20, 2011), http://www.dtcc.com/about/history/.

[137] *An Introduction to DTCC Services and Capabilities* (The Depository Trust & Clearing Corporation) at 2(Aug. 16, 2011). *See also*, *An Overview*, The Depository Trust & Clearing Corporation (last visited Nov. 20, 2011), http://www.dtcc.com/downloads/about/Introduction_to_DTCC.

[138] *Following a Trade: A Guide to DTCC's Pivotal Roles in How Securities Change Hands* (The Depository Trust & Clearing Corporation) at (Aug. 16, 2011). *See also*, *Products & Services Equities Clearance*, The Depository Trust & Clearing Corporation (last visited Nov. 20, 2011), http://www.dtcc.com/downloads/about/Broker_to_Broker_Trade.

[139] *About DTCC: National Securities Clearing Corporation* (The Depository Trust & Clearing Corporation)(Aug. 17, 2011). *See also*, *About DTCC: National Securities Clearing Corporation (NSCC)*, The Depository Trust & Clearing Corporation *(last visited Nov. 20, 2011), http://www.dtcc.com/about/subs/nscc.php.

the NYSE) and the DTC. The NSCC takes all the trade information from an exchange and acts as a central counterparty guaranteeing the trade. A summary of the net securities positions and net money to be settled as a result of that day's transactions is transmitted to the broker.[140]

135. Founded in 1973 and operating under the jurisdiction of the SEC and the Commodity Futures Trading Commission ("CFTC"), the OCC is the largest equity derivatives clearing organization. The OCC clears U.S. listed options and futures on numerous underlying financial assets including common stocks, currencies and stock indexes.

136. The OCC clears transactions for put and call options on common stocks and other equity issues, stock indexes, foreign currencies, interest rate composites and single-stock futures.

137. As a registered Derivatives Clearing Organization ("DCO") under the CFTC's jurisdiction, the OCC offers clearing and settlement services for transactions in futures and options on futures. Additionally, the OCC provides central counterparty clearing and settlement services for securities lending transactions.[141]

(i) Reconciliation of House 5 holdings to House 17 holdings via DTC records.

138. BLMIS maintained an account with the DTC (the "0646" account) for which trades would be cleared and/or custodied.[142] However, based on our investigation and analysis of available DTC documentation during the time period of October 2002 through October 2008, only securities positions for House 5 clients (including those out of MSIL) as recorded on House 5 trading records were held at DTC.[143] Accordingly, there is no evidence that the security holdings purportedly held on behalf of House 17's customers were held at DTC for the time period examined.

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[140] *Following a Trade* (The Depository Trust & Clearing Corporation), Aug. 16, 2011 at 6. *See also*, Products & Services Equities, *supra*..

[141] *See What is the OCC?*, The Options Clearing Corporation (last visited Nov. 20, 2011), http://www.theocc.com/about/corporate-information/what-is-occ.jsp.

[142] BLMIS had a DTC account from at least 1977. *See* The Depository Trust Participant Agreement, June 1977. SNOW0000658-SNOW0000733 *See also* the February 13, 2007 email from BLMIS to a customer stating, "We clear through DTC." IBLSAA0000350

[143] Records for the DTC were only available back to January, 2002. A trade reconciliation process from House 17 to MSIL was performed, which concluded that, based on execution and volume data, trades from House 17 were not executed by MSIL.

139. For the years 2002-2008, the following analysis was performed:

- Identified all unique securities positions purportedly held by House 17 on October 31st of each year as this was the fiscal year-end for BLMIS ("Step 1");[144]
- Identified unique securities held by House 5 that corresponded to those identified in Step 1 on October 31st of each year ("Step 2");
- DTC BLMIS position records were identified for the securities in Step 2.

140. For the seven year period analyzed, all of the securities identified in Step 2, which were held on behalf of House 5 customers as reported in House 5 trading records, were reconciled to the DTC thus, confirming that the House 5 securities positions in fact existed.

141. The remaining securities purportedly held on behalf of House 17 customers as recorded in the House 17 trading record, were not shown on DTC records and were not held at DTC; therefore, they could not have been legitimately executed as reported by BLMIS to its House 17 customers.

142. Further, Figure 15 below compares the purported House 17 securities positions with the House 5 securities positions in common as of October 31 from 2002-2008. As shown in Figure 15, the extreme volume of purported equity positions from House 17 on each October 31 dwarfs the numbers of the actual positions from House 5 that were reconciled with the DTC.

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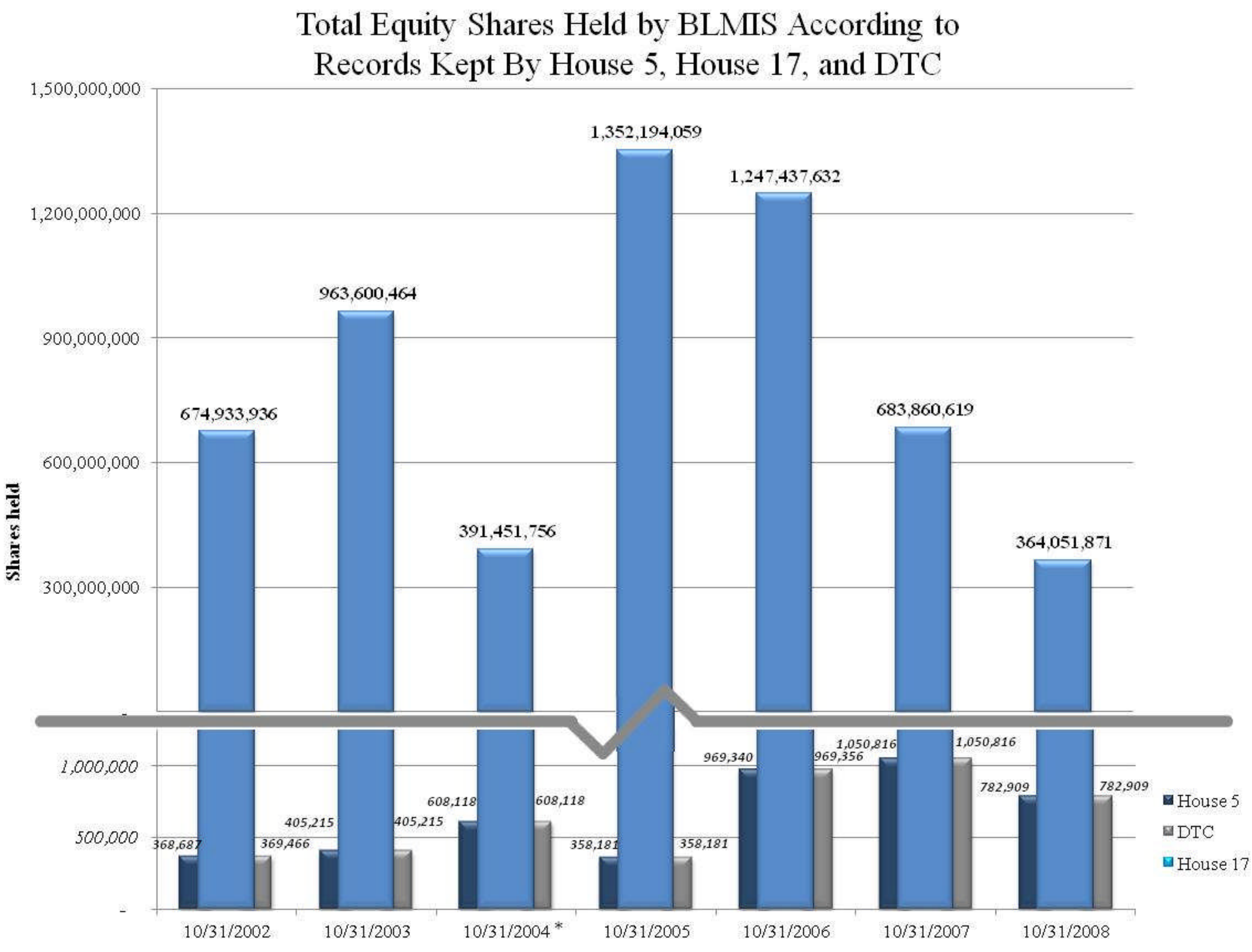
[144] October 31 was the fiscal year-end for BLMIS and was the date for which DTC records were available for the 2002-2008 time period.

Figure 15



* October 31, 2004 occurred on a Sunday. Friday, October 29, 2004 is the last trading day of the month and data on this date represents month-end DTC holdings.

(ii) Fake DTC Screen Reports created by House 17

143. Over 160 documents purportedly containing screen print-outs representing DTC inquiry look-ups were found in the records of BLMIS.[145] However, upon closer forensic examination, the documents contain typed-in text that appears to replicate certain DTC system screens. The metadata contained within these documents show that the documents were created after the supposed date of the screen look-up inquiry as depicted in the text within the document.

145 ELIP-BR00004715-4876

144. For example, ELIP-BR00004720 contained the following text which was typed into the document:

Figure 16

```
        _ ACTD   _ ART    _ PEND   _ RMCI   _ SETP   _ ____   _ Help

 KMXR/POS /POS0          THE DEPOSITORY TRUST COMPANY            Date: 11/30/2006
 00000646-03            Security Position Inquiry:Other POS      Time: 16:13:35
 ================================================================================
Part: 0646 MADOFF LLC CUSIP: 00206R102 AT & T INC       <    Date: 11 / 30 / 2006
 Last Actv Date: 11/30/2006  Status: FAST WT SDFS
 CUSIP Chills:
OTHER POSITION                                    TOTALS  Amount of TOTAL which is:
 _ Pledged--->                                         0   IPO:              N/A
 _ Segregation----------------->:              8,545,639
 _ Investment ID--------------->:                      0
 _ Reorganization MA/NA-------->:                      0
   Call With Interest---------->:                      0
   Call With OUT Interest------>:                      0
   Withdrawal By Transfer------>:                      0
                                       -----------------
 TOTAL OTHER Position---------->:              8,545,639
 TOTAL RESERVED Pos(PDA + PTA)->:                      0
 TOTAL FREE  Position---------->:                  4,378
                                       -----------------
 TOTAL PARTICIPANT Position---->:              8,550,017
 ==================================================================== PAGE 2
 1/13:FREE Position 3/15:MISC Holdings 4/16:Prev-Day 5/17
```

ELIP-BR00004720

145. A forensic examination of the metadata embedded in this document shows the following:[146]

File Name: ELIP-BR00004720.doc
Title: _ ACTD _ ART _ PEND _ RMCI _ SETP _ ____ _ Help
Author: Eric Lipkin
App Name: Microsoft Office Word
Version: 11.8107
Date Created (OLE): 12/19/2006 11:16:00 AM
Date Last Printed: 1/2/2007 2:35:00 PM
Date Last Saved: 1/19/2007 1:56:00 PM
Total Edit Time: 105
Template: Normal.dot
Shared: False
Company: Bernard L. Madoff Investments LLC.
Last Saved By: Eric Lipkin
Word Count: 290
Page Count: 1
Paragraph Count: 3

[146] Metadata was examined utilizing Pinpoint Laboratories Metaview program.

146. While the text in the document indicates that the information was obtained from DTC on November 30, 2006 at 16:13:35 hrs, the metadata shows that this document was actually created on December 19, 2006 11:16:00 AM, twenty days <u>after the date which appears in the text of the document.</u>

147. More importantly, the fake DTC screen print shows that BLMIS is holding 8,550,017 shares of AT&T common stock as of November 30, 2006. Yet according to DTC reports, BLMIS only held 4,378 shares of AT&T on November 30, 2006.

148. Further, the following two documents (Figure 17 and Figure 18 respectively) contain information pertaining to two different United States Treasury bills yet show the exact same date and time stamp when they were supposedly retrieved from the DTC system.

Figure 17

```
        _ ACTD  _ ART   _ PEND  _ RMCI  _ SETP  _ ____  _ Help

 KMXR/POS /POS0         THE DEPOSITORY TRUST COMPANY          Date: 01/05/2007
 00000646-03           Security Position Inquiry:Other POS    Time: 16:37:27
 ==============================================================================
Part: 0646 MADOFF LLC CUSIP: 912795YX3 00.000BILL070315BE#  Date: 01 / 04 / 2007
 Last Actv Date: 12/29/2006  Status: SDFS
 CUSIP Chills: DEP,    COD,    W/T,
OTHER POSITION                              TOTALS  Amount of TOTAL which is:
_ Pledged--->                                    0   IPO:                N/A
_ Segregation----------------->:       891,400,000
_ Investment ID--------------->:                 0
_ Reorganization MA/NA-------->:                 0
  Call With Interest--------->:                 0
  Call With OUT Interest------>:                 0
  Withdrawal By Transfer------>:                 0
                                  -----------------
 TOTAL OTHER Position--------->:       891,400,000
 TOTAL RESERVED Pos(PDA + PTA)->:                0
 TOTAL FREE  Position--------->:                 0
                                  -----------------
 TOTAL PARTICIPANT Position---->:       891,400,000
 ======================================================================= PAGE 2
 1/13:FREE Position 3/15:MISC Holdings 4/16:Prev-Day 5/17:N   ELIP-BR00004761
```

Figure 18

```
        _ ACTD  _ ART   _ PEND  _ RMCI  _ SETP  _ ____  _ Help

 KMXR/POS /POS0          THE DEPOSITORY TRUST COMPANY        Date: 01/05/2007
 00000646-03            Security Position Inquiry:Other POS  Time: 16:37:27
 ============================================================================
Part: 0646 MADOFF LLC CUSIP: 912795YY1 00.000BILL070322BE#  Date: 01 / 04 / 2007
 Last Actv Date: 12/29/2006  Status: SDFS
 CUSIP Chills: DEP,    COD,    W/T,
OTHER POSITION                               TOTALS  Amount of TOTAL which is:
 _ Pledged--->                                    0   IPO:               N/A
 _ Segregation----------------->:       891,400,000
 _ Investment ID--------------->:                 0
 _ Reorganization MA/NA-------->:                 0
   Call With Interest---------->:                 0
   Call With OUT Interest------>:                 0
   Withdrawal By Transfer------>:                 0
                                   ----------------
 TOTAL OTHER Position---------->:       891,400,000
 TOTAL RESERVED Pos(PDA + PTA)->:                 0
 TOTAL FREE  Position---------->:                 0
                                   ----------------
 TOTAL PARTICIPANT Position---->:       891,400,000
 ============================================================================ PAGE 2
 1/13:FREE Position 3/15:MISC Holdings 4/16:Prev-Day 5/17:N
```

ELIP-BR00004767

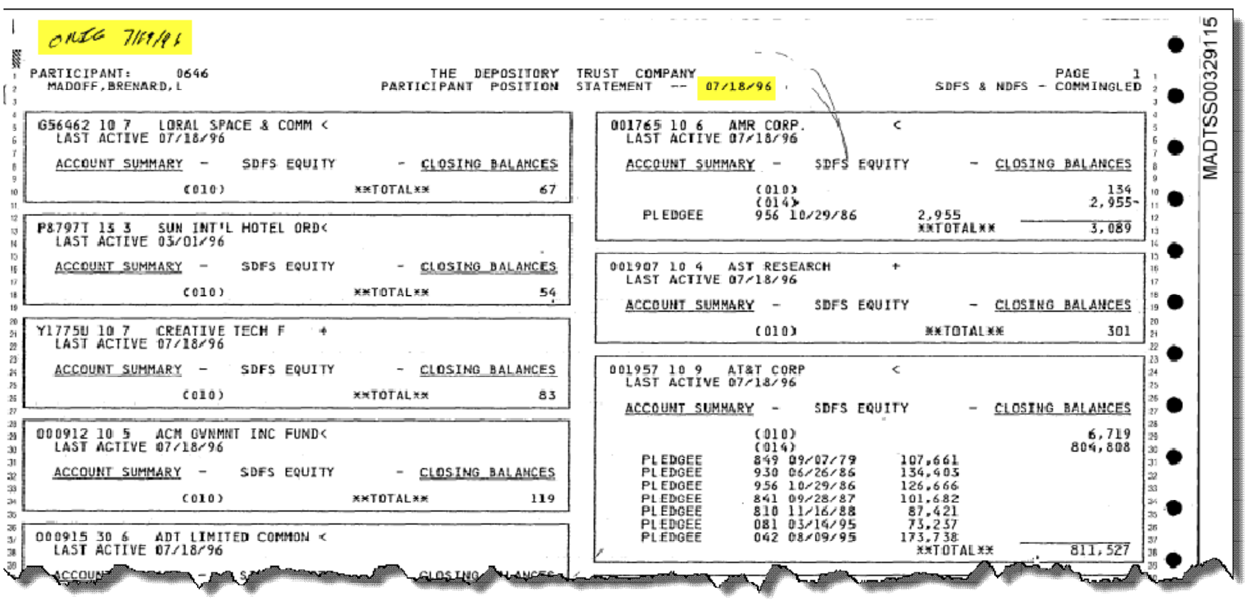
149. The fictitious nature of these documents is clearly evident since there would be no way to print these DTC screen inquiry reports for account 0646-Madoff from DTC at the exact same minute and second as depicted on both documents. In fact, embedded metadata for these two documents show that the first document, ELIP-BR00004761, was created on January 5, 2007 at 11:48 a.m. some four hours before the date depicted in the document. The second document, ELIP-BR00004767, was also created on January 5, 2007 at 11:48 a.m. four hours before the date depicted in the document. Creation of these fictitious DTC screens serves no legitimate business purpose other than to document purported trading activity that did not actually occur.

150. In addition to the fake DTC documents described above, additional investigation revealed that House 17 custom-developed software was created to print a replica of a report called the Customer Position Statement from DTC. The imitation report was populated with the fictitious securities holdings to make it appear that House 17 actually had custody of the purported securities recorded on its customer statements. Three components of computer programs were located on the AS/400 system in House 17 and were utilized in combination to create the fake DTC participant position report:

- A data file named DTCABAL containing fictitious security positions.
- A Report Program Generator (RPG) II program named DTC021 that formats the data from DTCABAL, adding headers and formatting to the data to replicate the look and feel of a real DTC report.
- A form definition file named DTCS that instructs the FormsPrint software (published by Integrated Custom Software, Inc.) to apply additional formatting to the report to further approximate the look-and-feel of a real DTC report.

151. As part of the investigation, a copy of an actual DTC report from House 5 as of July 18, 1996 was found that was apparently utilized by BLMIS as the source for designing the imitation DTC report. A portion of that report appears in Figure 19.[147]

Figure 19



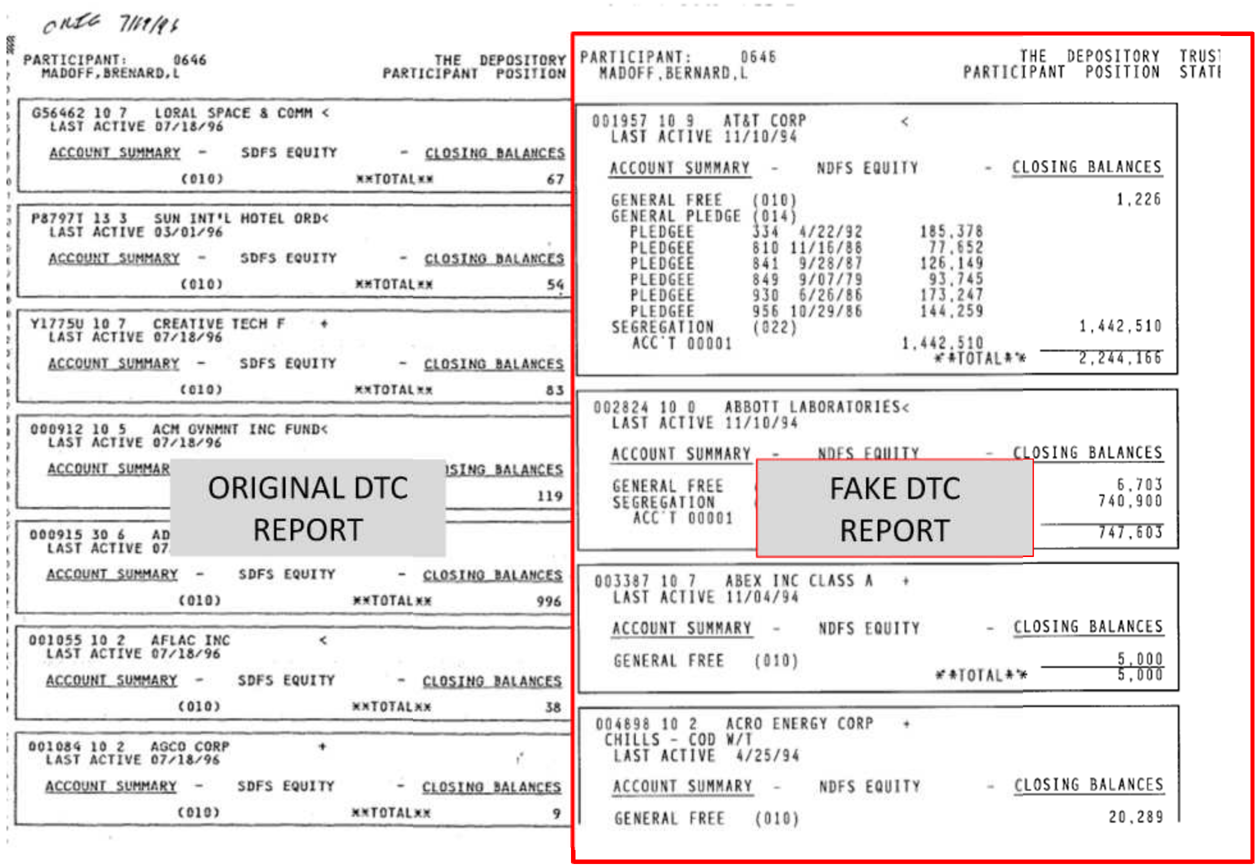
```
ORIG 7/19/96

PARTICIPANT:      0646                        THE  DEPOSITORY  TRUST  COMPANY                              PAGE     1
  MADOFF,BRENARD,L                        PARTICIPANT  POSITION  STATEMENT  --  07/18/96       SDFS & NDFS - COMMINGLED

G56462 10 7   LORAL SPACE & COMM <
  LAST ACTIVE 07/18/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)              **TOTAL**                67

P8797T 13 3   SUN INT'L HOTEL ORD<
  LAST ACTIVE 03/01/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)              **TOTAL**                54

Y1775U 10 7   CREATIVE TECH F    +
  LAST ACTIVE 07/18/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)              **TOTAL**                83

000912 10 5   ACM GVNMNT INC FUND<
  LAST ACTIVE 07/18/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)              **TOTAL**               119

000915 30 6   ADT LIMITED COMMON <
  LAST ACTIVE 07/18/96

001765 10 6   AMR CORP.          <
  LAST ACTIVE 07/18/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)                                      134
                 (014)                                    2,955-
   PLEDGEE       956 10/29/86       2,955
                                  **TOTAL**               3,089

001907 10 4   AST RESEARCH       +
  LAST ACTIVE 07/18/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)              **TOTAL**               301

001957 10 9   AT&T CORP          <
  LAST ACTIVE 07/18/96
  ACCOUNT SUMMARY  -   SDFS EQUITY         -  CLOSING BALANCES
                 (010)                                    6,719
                 (014)                                  804,808
   PLEDGEE       849 09/07/79     107,661
   PLEDGEE       930 06/26/86     134,403
   PLEDGEE       956 10/29/86     126,666
   PLEDGEE       841 09/28/87     101,682
   PLEDGEE       810 11/16/88      87,421
   PLEDGEE       081 03/14/95      73,237
   PLEDGEE       042 08/09/95     173,738
                                  **TOTAL**             811,527

MADTSS00329115
```

152. Through detailed computer analysis, the fake DTC report was re-created using the DTCABAL file, the DTC021 RPG program, and the FormsPrint software located on a system

[147] This document contained numerous handwritten notes (*see* pages MADTSS00329120- MADTSS00329124) where the writer commented on the difficulty of changing the point size of the text without rendering the size of the entire page too big, thus showing the steps undertaken to try to create an exact replica of the official DTC report. MADTSS00329114-127

backup tape from the BLMIS location (*see* below for screen shots of the data files). The fake report appears below in Figure 20:

Figure 20



153. There is no legitimate business reason to generate a fake DTC report, as a legitimate trading or investment advisory business would be directly connected to the DTC to process trades and would have the ability to generate original participant position statement reports directly from the DTC. This further supports the opinion that the House 17 trading did not occur.

Figure 21

Excerpt from DTCABAL data file

```
 Browse : JCP/DTCABAL2(DTCABAL)
 Record : ______1   of      12 by __18                         Column : ___1    200 by 131
 Control : ___________________________________________________________________

....+....1....+....2....+....3....+....4....+....5....+....6....+....7....+....8....+....9....+....0....+....1....+
             ************Beginning of data**************
001957109010                      0000000064610111094000000000001226AT&T CORP           <0000000AT&T CORP          <
0019571090143334042292            0000000064610111094000000000185378AT&T CORP           <0000000AT&T CORP          <
0019571090148101116888            0000000064610111094000000000077652AT&T CORP           <0000000AT&T CORP          <
0019571090148410922887            0000000064610111094000000000126149AT&T CORP           <0000000AT&T CORP          <
0019571090148490907779            0000000064610111094000000000093745AT&T CORP           <0000000AT&T CORP          <
0019571090149300626886            0000000064610111094000000000173247AT&T CORP           <0000000AT&T CORP          <
0019571090149561029886            0000000064610111094000000000144259AT&T CORP           <0000000AT&T CORP          <
001957109022                      00000000646101026110000001442510AT&T CORP             <0000000AT&T CORP          <
002824100010                      0000000064610111094000000000006703ABBOTT LABORATORIES<0000000ABBOTT LABORATORIES<
002824100022                      00000000646101026110000000740900ABBOTT LABORATORIES<0000000ABBOTT LABORATORIES<
003387107010                      0000000064610110494000000000005000ABEX INC CLASS A   +0000000ABEX INC CLASS A    +
004898102010                      0000000064610042594000000000020289ACRO ENERGY CORP   +0000110ACRO ENERGY CORP    +
             ************End of Data********************
```

Figure 22

PORTION OF DTC021 RPG Code

```
0001 H     16                1                  DTC021
0002 F**************************************************************BTS002
0003 F* PROCEDURE: DTCPPST1                                *BTS002
0004 F* DTC021- PRINT DTC PARTICIPANT POSITION STATEMENT REPORT.      *BTS002
0005 F*       NO LONGER DOWN LOAD TO REDACTED NTED ON AS/400       *BTS002
0005 F*       LASER USING FORMSPRINT                        *BTS002
0005 F*                   CREATED 11-08-95  REDACTED   *BTS002
0003 F*                                     *BTS002
0006 F**************************************************************BTS002
0017 FDTCAPIBAIPE F2000 200          DISK
0012 FPRINT   O   F 198 198          PRINTER            BTS002
0012 F*                                     BTS002
0010 E              CHIL      42  1          CHILLS ARRAY    BKCS3J
0017 E*                                     DTC005
0018 IDTCAPIBANS  01                             DTC004
0022 I                         1  12 CUSTYPL1          DTC004
0022 I                         1   9 CUSIP L2        DTC004
0022 I                        10  12 ACTTYP          DTC004
0023 I                        13  150PLBANK          DTC004
0023 I                        16  210LOANDT          DTC004
0023 I                        22  280SERIAL          DTC004
0023 I                        29  29 REORCD          DTC004
0022 I                        30  32 RAMSCD          BKTR64
0023 I                        33  340RAMSEQ          BKTR64
0024 I                        35  400TRADDT          BKTR64
0024 I                        41  450PART#           BKTR64
```

Figure 23

DTCS Form Specification for FormsPrint software from Integrated Custom Software, Inc.

DATA MAPPER - Variable Text Locations
DTCS

Ref	Definition	Page	Millimeters From Top	Millimeters From Left	Millimeters Right Edge	Lines	Equation
1	L1 Dont Print	1	5	5	100	1	NP
2	Header Line 1	1	14.2	5.4	270	1	A3502070/1/8/12 TRIM2/135
3	Header Line 2-3	1	17.38	5.4	270	2	A3502070/1/8/12 TRIM2/135
4	Macro Calls	1	23.73	4	206	56	TRIM1/5
5	Data	1	23.73	8	206	56	COPYR4 TRIM7/67
6							A3502070/1/8/12
7	L61	1	5	5	100	1	PG
8							
9							
10							
11							
12							
13							
14							
15							

F1=Flash F2=Print Def F3=Go To ___ F4=Prev Screen F5=Next Screen F9=Para Select
F10=Copy Ref ____ through ____ to Ref ____ and Step Top ____ Step Left ____
F14=Help F15=Print F17=Insert Line F18=Delete Line F12=Return F24=First Menu

Figure 24

DTCS Box Definition Screen

F O R M F L A S H D E F I N I T I O N
BOX DEFINITIONS - Page 1-1

Left Edge	Right Edge	Top	Bottom	Width	Density	Fill Density	Number	Spacing Horiz	Spacing Vert
4	10	5	10	1	1	0	0	0	0

F2=Prev Page F3=Next Page F4=Prev Screen F5=Next Screen F17=Insert F18=Delete
F6=Vertical Lines F7=Horizontal Lines F8=Boxes F9=Graphics F10=Text F15=Print
F13=Multipage Copy/Delete F14=Macros/Pages F12=Return F24=First Menu

(iii) Reconciliation of House 5 options trades to OCC.

154. BLMIS maintained an account with the OCC for clearing equity option trades, such as those purportedly made in accordance with the split strike conversion strategy (explained in more detail herein). However, based on the investigation and analysis of the OCC documentation available for October 2002 through October 2008, only option trades executed for House 5 clients (as well as those from MSIL) as reported on House 5 trading records, were cleared through OCC. Accordingly, there is no evidence that any options purportedly executed on behalf of House 17's customers ever cleared through the OCC for the time period examined.

155. A similar analysis as described *supra* for House 17's equity trades was performed with respect to options transactions. For the years 2002-2008:

- Identified all unique options traded in House 17 as of October 31st of each year as this was the fiscal year-end for BLMIS ("Step 1");[148]
- Identified options traded out of House 5 that matched those identified in Step 1 as of October 31st of each year ("Step 2");
- OCC clearing records were identified for the options in Step 2.

156. For the seven year period analyzed, all of the options identified in Step 2, which were traded on behalf of House 5 customers as reported in House 5 trading records, were reconciled to the OCC thus confirming that the House 5 options in fact occurred and cleared.

157. The remaining options purportedly traded on behalf of House 17 customers as recorded in the House 17 trading records, were not shown on OCC records and were not cleared through OCC; therefore they could not have been legitimately executed as reported by BLMIS to its House 17 customers.

158. For example, on October 31, 2005, records from House 5 and the OCC indicate that 20 options described as "S&P 100 INDEX NOVEMBER 590 CALL" were purchased and held by BLMIS. The aggregate number of "S&P 100 INDEX NOVEMBER 590 CALL" options as reported on the House 17 customer statements for the same date number 658,342.

---

[148] October 31 was the fiscal year end for BLMIS and was the date for which OCC records were available for the 2002-2008 time period.

Therefore, options purportedly traded and held for House 17 could not have been executed through House 5 nor were they cleared through the OCC account associated with BLMIS.

e. Approximately $4.3 billion of dividends reported on House 17 customer statements were fictitious and were never received by BLMIS on behalf of its customers.

159. For shares held in brokerage accounts, the default choice for receiving dividend payments is for the distributing company (i.e. the company actually declaring and paying the dividend) to credit to the brokerage firm (in this case, BLMIS) for the entirety of the dividends to be delivered to the brokerage firm's customers. On payment dates, the brokerage firm will credit the applicable apportioned dividend amount to accounts of customers who are shareholders of record of the companies that have declared and paid the dividends.[149]

160. Although BLMIS was regularly recording dividend payments on House 17 customer statements, the evidence is that such dividend payments were never received by BLMIS.

161. House 17 customer account statements reflect dividend payments from the securities purportedly held in their respective customer accounts. To test whether House 17 actually received the dividend payments which were being reflected in the customer account statements, account number 1-B0039-3-0 was randomly selected in order to identify securities for which dividends were paid.

162. Figure 25 below shows the January 31, 2007 customer account statement for account 1-B0039-3-0 and identifies the dividend payments that were purportedly received during that month:

---

[149] *See* SEC Transfer Agents, *supra*, *Holding Your Securities – Get the Facts*, U.S. SEC (last visited Nov. 20, 2011), http://www.sec.gov/investor/pubs/holdsec.htm; *Transfer Agent*, United Technologies, (last visited Nov. 20,2011), http://utc.com/Investor+Relations/Transfer+Agent.

Figure 25

REDACTED

1/31/07 1

REDACTED

				BALANCE FORWARD			.55
1/02				MERCK & CO DIV 12/08/06 1/02/07	DIV		1,046.52
1/02				PEPSICO INC DIV 12/08/06 1/02/07	DIV		612.00
1/02				WAL-MART STORES INC DIV 12/15/06 1/02/07	DIV		512.55
1/03				HEWLETT PACKARD CO DIV 12/13/06 1/03/07	DIV		277.44
1/04				UNITED PARCEL SVC INC CLASS B DIV 11/27/06 1/04/07	DIV		503.88
1/05				SCHLUMBERGER LTD DIV 12/06/06 1/05/07	DIV		178.50
1/31				FIDELITY SPARTAN U S TREASURY MONEY MARKET DIV 01/31/07	DIV		144.26
1/31		34,219	17529	FIDELITY SPARTAN U S TREASURY MONEY MARKET	1		34,219.00
1/31	25,000		22239	U S TREASURY BILL DUE 4/12/2007 4/12/2007	99.020	24,755.00	
1/31	12,739		24190	FIDELITY SPARTAN U S TREASURY MONEY MARKET	1	12,739.00	

CONTINUED ON PAGE 2

MDPTPP00131984

163. Based on this customer statement, all dividends purportedly received by all House 17 customers for these same securities for all of January 2007 were then aggregated and analyzed. These amounts are summarized below:[150]

Table 5

Payment Date	Company	Dividends
January 2, 2007	Merck & Co	$ 6,404,388
January 2, 2007	Pepsico Inc	3,876,222
January 2, 2007	Walmart Stores Inc	3,255,099
January 3, 2007	Hewlett Packard Co	3,166,718
January 4, 2007	United Parcel Services Inc	3,155,807
January 5, 2007	Schlumberger Ltd	1,152,440
January 31, 2007	Fidelity Spartan	467,950
Total		**$ 21,478,624**

[150] The Fidelity Spartan U.S. Treasury Money Market Fund continued to be referenced by House 17 as such even though its name changed to the Fidelity U.S. Treasury Money Market Fund effective August 15, 2005. *Prospectus*, Fidelity Spartan U.S. Treasury Money Market Fund, U.S. Government Money Market Fund, & Money Market Fund (June 29, 2005).

164. As previously discussed, these purported dividend payments, if actually received by BLMIS, would have been delivered to BLMIS by the distributing companies' respective transfer agents. At the time of the January 2007 dividend payments, the transfer agents for the above selected companies were:[151]

Table 6

Company	Transfer Agent
Merck & Co	Wells Fargo Bank
Pepsico Inc	The Bank of New York
Walmart Stores Inc	Computershare Trust Company
Hewlett Packard Co	Computershare Trust Company
United Parcel Services Inc	Mellon Investor Services
Schlumberger Ltd	Computershare Trust Company
Fidelity Spartan	Fidelity Service Company

165. An analysis was then conducted of all House 17 bank account statements for the months of December 2006 and January 2007 to determine whether or not there were additions to the BLMIS bank accounts in the amounts reflecting the purported total dividend payments to the House 17 customers.[152] No transactions from the above transfer agents or for the amounts indicated for the purpose of dividend payments were identified. Without these distributions directly from the corporations, these dividend payments to BLMIS (and its customers) could not have actually occurred.

166. Additional analyses were performed on dividends purportedly received by all House 17 customers between the years 1998 through 2008.[153] During this time period, there were over 8,300 dividend transactions (on an aggregate basis for approximately 6,500 customer accounts) totaling approximately $4.3 billion of dividend payments reflected on customer account statements.[154] A breakdown by year of these dividend payments is shown below:

---

[151] Transfer agents were identified by reviewing 2006 and 2007 year-end SEC filings (e.g., proxy statements and/or annual reports). In all cases the transfer agents identified by these reports were the same in both years, confirming the transfer agents identified in the table.

[152] A search for additions in the amounts listed as well as amounts approximating these amounts was conducted to ensure that all possibilities were considered. No such matches or approximate matches were found. In fact, no transactions from any of the transfer agents representing any amount of dividend payments were noted.

[153] House 17 bank account statements were available from December 1998 through December 2008.

[154] A complete database of dividend payments from customer statements was available from December 1995 through December 2008. Total purported dividend distributions for this period totaled $4,594,442,711.77. While BLMIS bank statements prior to 1998 are no longer available from the bank and were not found in the BLMIS records,

Table 7

Year		Dividends
1998	$	137,316,449
1999		134,029,662
2000		139,026,901
2001		181,808,199
2002		228,056,457
2003		388,056,582
2004		701,081,346
2005		482,627,455
2006		839,021,313
2007		615,471,114
2008		493,162,860
Total	**$**	**4,339,658,338**

167. The dividend transactions reported on the House 17 customer account statements were compared to the House 17 bank statements (i.e., the 703 Account). Of the more than 8,300 dividend transactions traced, not one purported dividend payment matched to a cash addition on the BLMIS bank statements.

168. The foregoing analysis regarding dividend payments further shows that trading in House 17 did not occur.

f. House 17 was "Schtupping" certain customer returns.

169. Documents and computer programs uncovered in the course of the investigation revealed that House 17 was falsifying customers' purported investment returns through the use of fictitious trades implemented through a special basket trading program. The name of the special basket trading program was called "B.SCHUPT [*sic*]". The word "schtup" is a Yiddish word meaning to "push" connoting the act of giving an extra effort in order to meet expectations.[155] While the special basket trading file was named B.SCHUPT [*sic*] it is logical to conclude that this was simply a spelling error on the part of the House 17 employee(s) who devised the name.

nevertheless, there was no legitimate documentary evidence that any prior dividend payments were ever received by BLMIS on behalf of its House 17 customers.

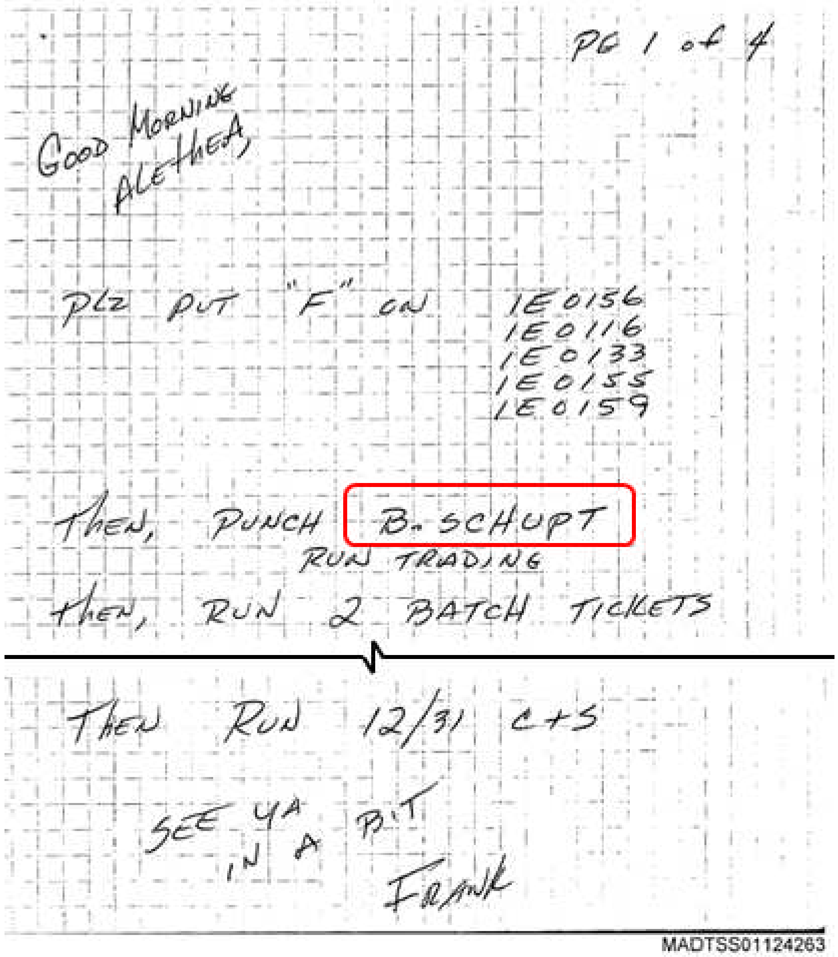
[155] *See Schtup*, Yiddish Dictionary Online (last visited Nov. 20, 2011), http://www.yiddishdictionaryonline.com.

170. The investigation revealed that the use of the B.SCHUPT [*sic*] program was to allow for the truing up of customer accounts whose fictitious trades throughout the year had not yielded the rates of return that had been targeted by House 17. In fact, certain House 17 customer accounts were analyzed and it was determined that these accounts achieved over a 250% return in less than a 30-day period as a result of additional fictitious option trades implemented through the B.SCHUPT [*sic*] trades.

171. For example, in December 2003, a four-page packet of instructions (two pages of which were handwritten instructions signed by DiPascali) contained explicit instructions and details surrounding a B.SCHUPT [*sic*] special trading basket that was to be run for that period.[156] The instructions included 29 accounts that were to receive the benefits of the special B.SCHUPT [*sic*] option trades.

[156] *See* MADTSS01124263-68

Figure 26



PG 1 of 4

GOOD MORNING
ALETHEA,

PLZ PUT "F" ON 1E0156
1E0116
1E0133
1E0155
1E0159

THEN, PUNCH B. SCHUPT
RUN TRADING
THEN, RUN 2 BATCH TICKETS

THEN RUN 12/31 C+S

SEE YA
IN A BIT
FRANK

MADTSS01124263

172. To investigate the effect of the B.SCHUPT [*sic*] option trades, one test account was initially selected for detailed analysis. Account 1B0227 was selected from the listing. This account was to receive 1.5 units of the special basket trade.