UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: BERNARD L. MADOFF, 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) Case No. 11-Civ-03605 (JSR)

TRUSTEE'S MEMORANDUM OF LAW IN OPPOSITION TO THE DEFENDANTS' MOTION TO STRIKE THE EXPERT REPORTS AND TESTIMONY OF DR. STEVE POMERANTZ

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Irving H. Picard, as trustee ("Trustee") for the substantively consolidated liquidation proceedings of Bernard L. Madoff Investment Securities LLC ("BLMIS") under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa *et seq.*, and the estate of Bernard L. Madoff ("Madoff"), by and through his undersigned counsel, hereby submits this memorandum of law in opposition to the Defendants' Motion to Strike the Expert Reports and Testimony of Dr. Steve Pomerantz ("Pomerantz"), dated Jan. 26, 2012,[1] (hereinafter, the "Motion").

PRELIMINARY STATEMENT

In connection with his retention, Pomerantz prepared and signed a November 22, 2011 Expert Report ("Pomerantz Report"),[2] and a December 13, 2011 Rebuttal Report ("Pomerantz Rebuttal")[3] (collectively, the "Reports"). The Trustee offers Pomerantz to: (i) provide a necessary background of the securities and investment management industry; (ii) analyze whether, based on a review of documents, testimony and qualitative and quantitative analyses, there were red flags associated with the Defendants' investment accounts at BLMIS; (iii) determine whether, based on any such red flags, a similarly-situated investor would have conducted additional due diligence; and (iv) describe what real-time due diligence, conducted on the Defendants' accounts, would have revealed.

Pomerantz has over 25 years of experience in the securities and financial industry. He has held several high-ranking positions at major investment management firms such as Bank of America, Morgan Stanley, Citibank, Nomura Securities International, and Weiss, Peck & Greer.

[1] The Trustee opposes the Defendants' Motion to Strike the Expert Reports and Testimony of Harrison J. Goldin, dated January 26, 2012, in a separate memorandum of law.

[2] Declaration of David J. Sheehan in Opposition to the Defendants' Motion to Strike the Expert Reports and Testimony of Dr. Steve Pomerantz, dated February 09, 2012, Exhibit 1 ("Sheehan Decl. Ex. __").

[3] Sheehan Decl. Ex. 2.

During this time, he has provided portfolio management and risk management services to investments similar to those at issue in this case. He has managed other people's money, has had due diligence performed on investments he himself managed, and has performed due diligence on hundreds of investment vehicles—including BLMIS. He has worked for and consulted with many high-net worth investors, sophisticated investors, and institutional investors.[4]

The Defendants do not challenge Pomerantz's qualifications or the reliability of the methodology and principles that he applies to the facts of this case. Instead, the Defendants' only challenge the Reports' relevance.[5] Defendants' relevance arguments are contrary to settled law. Their challenge to two small excerpts from Pomerantz's deposition testimony as "legal conclusions" is equally without support. Defendants' Motion should be denied.

ARGUMENT

The presumption in favor of admitting expert testimony is not rebutted here. *See, e.g.*, *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 595-96 (1993) (courts should err on admitting expert testimony and subjecting it to "[v]igorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof"); *see also U.S. v. Duncan*, 42 F.3d 97, 101 (2d Cir. 1994) ("Expert witnesses are often uniquely qualified in guiding the trier of fact through a complicated morass of obscure terms and concepts."). Pomerantz's qualifications are unchallenged and more than satisfy this Circuit's qualification requirements for expert witnesses. *See U.S. v. Brown*, 776 F.2d 397, 400-01 (2d Cir. 1985). Moreover, Pomerantz's proposed testimony: (i) consists of specialized knowledge that will help the trier of fact to understand the evidence or determine a fact in issue; (ii) relies on sufficient facts or data; (iii)

[4] Pomerantz Report at ¶¶ 2-4, 8-11.

[5] Defendants' Memorandum of Law in Support of their Motion to Strike the Expert Reports and Testimony of Dr. Steve Pomerantz at 7-10, dated Jan. 26, 2012 (hereinafter "Defs. Br. at __").

utilizes reliable principles and methods; and (iv) relevantly applies these principles and methods to the facts of this case. Fed. R. Evid. 702 (2000); *see generally The Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Amer. Secs., LLC*, 691 F. Supp. 2d 448, 457-58 (S.D.N.Y. 2010).

Accordingly, and as set forth fully below, the Defendants' challenges to Pomerantz's Reports and proposed testimony fail.

I. POMERANTZ'S TESTIMONY IS NECESSARY AND RELEVANT

A. Pomerantz's Testimony Is Necessary

Pomerantz's testimony will help the jury understand the evidence in this case. *Highland Cap. Mgmt. L.P. v. Schneider*, 551 F. Supp. 2d 173, 178-79 (S.D.N.Y. 2008) *aff'd*, 2008 WL 3884363, at *12 (S.D.N.Y. Aug. 20, 2008) (expert testimony that helps the jury understand the evidence is admissible). Typically, securities cases require expert testimony to guide the jury through "unfamiliar terms and concepts" that are beyond a layperson's understanding. *U.S. v. Bilzerian*, 926 F.2d 1285, 1294 (2d Cir. 1991); *S.E.C. v. Badian*, 06 Civ. 2621 (LTS), 2010 WL 4840063, at *3 (S.D.N.Y. Nov. 19, 2010) ("The types of factual situations that constitute red flags probative of possible misconduct are outside of the lay jury's experience and observation."). This is especially true where, as here, one of the ultimate issues before the jury is the Defendants' willful blindness to the probability of Madoff's fraud, which requires an intricate contextual understanding of the facts in this case. *See generally U.S. v. White*, 124 F.2d 181, 185 (2d Cir. 1941) (Hand, J.) (when it comes to proving scienter "the sum is often greater than the aggregate of the parts, and the cumulation of instances, each explicable only by extreme credulity or professional inexpertness, may have probative force immensely greater than any one of them alone"); *S.E.C. v. U.S. Envt'l, Inc. ("Envt'l II")*, 94 Civ. 6608 (PKL) (AJP), 2003 WL

21697891, at *22-24 (S.D.N.Y. July 21, 2003) (scienter is typically inferred from the defendants' actions and the circumstances in which they were made).

The Pomerantz Report offers a comprehensive, learned study and analysis of industry concepts, red flags, and due diligence, including by way of example:

- Volatility in markets (*e.g.*, Pomerantz Report at ¶¶ 25, 27, 34, 54, 82, 134-135, 162-164);
- Operational, transactional, qualitative, quantitative and ongoing due diligence practices (*e.g.*, *id.* at ¶¶ 8-12, 15-16, 18, 26-27, 30-35, 46, 49, 53, 57-59, 79);
- Risk management (*e.g.*, *id.* at ¶¶ 46-48, 51, 155, 158, 199);
- Investments managers (*e.g.*, *id.* at ¶¶ 11, 35-40, 42-51);
- Checks and balances provided by service providers (*e.g.*, *id.* at ¶¶ 27, 35-42,44-59); and
- Hedging strategies, equities, options and the purported "split-strike" strategy (*e.g.*, *id.* at ¶¶ 68-70, 87, 133-140, 173-174).

These are exactly the type of industry-specific matters that warrant the expertise of a securities insider like Pomerantz.[6] *Pension*, 691 F. Supp. 2d at 469 (plaintiff's expert was allowed to testify that hedge fund investors, similarly-situated to the defendants, would have uncovered red flags associated with their investments); *Badian*, 2010 WL 4840063, at *3 ("[A]llegation[s] that the [defendants] failed to respond properly to 'red flags' does require proof through expert testimony."); *Highland*, 551 F. Supp. 2d at 180-81 (expert could testify as to

[6] Defendants contend that Pomerantz's testimony is irrelevant and similar to his exclusion in *Atwater v. NFL Players Ass'n*, 6 Civ. 1510 (JEC), 2009 U.S. Dist. LEXIS 98236, at *12-14 (N.D. Ga. Mar. 26, 2009). (Defs. Br. at 10). The *Atwater* court ultimately excluded Pomerantz because his securities expertise was not needed in a labor dispute governed by a collective bargaining agreement and because the Securities and Exchange Commission had issued a No Action Letter dealing with the obligations of the defendant in that case. *Id.* Further, Pomerantz's prior witness history has no bearing on his admissibility here. *See Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 150-51 (1999) (expert admissibility determination is case-specific and fact-specific).

customs and practices of the securities industry relevant to the facts of the case); *In re Blech Secs. Litig.*, 94 Civ. 7696 (RWS), 2003 WL 1610775, at *19 (S.D.N.Y. Mar. 26, 2003) (plaintiff's expert could testify to how defendants' practices deviated from the norm in the securities industry).[7] Pomerantz's testimony will help the jury and is properly admitted here.

B. Pomerantz's Testimony Is Relevant

Pomerantz's Reports, as well as his expected trial testimony are probative of whether the Defendants' acted with the requisite state of mind set forth by this Court. Pomerantz analyzes and reports on how hypothetical, similarly-situated investors act pursuant to typical securities and financial industry practices and customs. For example, Pomerantz offers that:

- Similarly-situated investors would have performed additional qualitative and quantitative due diligence in connection with their BLMIS accounts since indicia of fraud regarding Madoff's purported strategy were prevalent (*Id.* at ¶ 27);
- The Defendants' investment accounts with BLMIS contained impossible, and virtually impossible, transactions that suggested a high probability of fraud (*Id.* at ¶¶ 27, 187-189, 196-198);
- Similarly-situated investors would have performed due diligence regarding the process Madoff employed in investing their money, and this further investigation would have uncovered a high probability of fraud at BLMIS (*Id.* at ¶¶ 132, 136, 137, 139, 142,143, 152);
- Similarly-situated investors would have monitored and continued a thorough and on-going due diligence of their investment portfolios which would have indicated, among other things, that there was a suspicious, off-the-charts level of consistent returns over more than two decades (*Id*. at ¶¶ 155, 157, 160);
- Similarly-situated investors would have performed customary due diligence on the performance of Madoff's purported strategy as applied to their accounts with BLMIS (*Id.* at ¶¶ 165, 166);
- Similarly-situated investors would have performed due diligence to understand BLMIS's irregular fee structure (*Id.* at ¶ 207); and

[7] *See also F.D.I.C. v. Refco Grp., Ltd.*, 184 F.R.D. 623, 631 (D. Colo. 1999) (plaintiffs could offer securities expert to opine about standards of care in the securities industry as evidence of defendants' knowledge of red flags linked to a Ponzi scheme).

- Similarly-situated investors would have performed due diligence to understand how Madoff continued to deliver double-digit returns with an S&P 100-based strategy, when the economy, including the S&P, was suffering significant, and at times massive double-digit, losses (*Id.* at ¶¶ 33-35, 60, 79-81, 84, 89, 91).

The Defendants posit that Pomerantz's Reports can only support a theory of negligence. (Defs. Br. at 1). The Defendants are wrong. Expert testimony relating to the Defendants' extreme departure from industry standards can (and does) support the Trustee's allegations and evidence that the Defendants were willfully blind to Madoff's fraud. *See Vernazza v. S.E.C.*, 327 F.3d 851, 862 (9th Cir. 2003) ("[E]xpert testimony might also be relevant to determine whether the [defendant's] conduct is so far outside the range of reasonable conduct so as to be considered reckless."); *U.S. v. Fauls*, 65 F.3d 592, 598 (7th Cir. 1995) (expert testimony suggesting the defendants acted with "deliberate indifference" supported district court's "'ostrich[]' instruction" to the jury); *Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525, 530 (9th Cir. 1986) (it was prejudicial error to exclude securities expert comparing defendants' actions to industry standards as evidence that the defendants intended to defraud or recklessly disregarded the securities laws); *Coquina Invs. v. Rothstein*, 10-60786-Civ., 2011 WL 4949191, at *4 (S.D. Fla. Oct. 18, 2011) (expert opinions about whether the defendant "ignored 'red flags' indicating fraud can be admissible circumstantial evidence relevant to whether [defendant] had knowledge of the fraud or was reckless in its actions"); *S.E.C. v. U.S. Envt'l, Inc. ("Envt'l I")*, 94 Civ. 6608 (PKL) (AJP), 2002 WL 31323832, at *3 (S.D.N.Y. Oct. 16, 2002) (expert testimony about red flags was admissible to show whether defendants acted with knowledge or reckless disregard); *S.E.C. v. Lorin*, 877 F. Supp. 2d 192, 196-98 (S.D.N.Y. 1995) (expert testimony about the defendants' conduct supported finding that defendants acted with the requisite scienter for securities fraud).[8]

[8] *See also Kearney v. Auto-Owners Ins. Co.*, 8:06-CV-595-T-24TGW, 2009 WL 3712343, at *10 (M.D. Fla. Nov. 5, 2009) (expert's comparison of the defendants' actions with industry standards was probative of whether the defendants acted in bad faith); *Refco Grp.*, 184 F.R.D. at 631

The Defendants imply that their willful blindness can only be proven through direct evidence coming from their own mouths.[9] This, too, is wrong. Willful blindness, or any "subjective" standard of scienter, is rarely proven through direct evidence; rather, it is usually inferred from the conduct and actions of the defendants. *Envt'l II*, 2003 WL 21697891, at *11, 22-24 (holding that objective evidence of red flags—including expert testimony—was sufficient to establish that defendants knew or recklessly disregarded indicia of securities fraud) (citing *S.E.C. v. Cooper*, 402 F. Supp. 516, 523-24 (S.D.N.Y. 1975)); *Gebhart v. S.E.C.*, 595 F.3d 1034, 1042 (9th Cir. 2010) (explaining that courts may "consider the objective unreasonableness of the defendant's conduct" in determining whether the defendant acted with knowledge, conscious disregard, and/or recklessness). Pomerantz's Reports and testimony will assist the jury in its willful blindness determination.[10] Fed. R. Evid. 401 (2011) (evidence that has a "tendency to make a fact more or less probable than it would be without the evidence" is relevant); *see also Smith v. First Union Nat'l Bank*, 00-4485-CIV, 2002 WL 34355951, at *1 (S.D. Fla. Aug. 27, 2002) (expert testimony about banking defendants' atypical behavior vis-à-vis financial industry

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(expert testimony that defendants' "conduct [was] inconsistent with industry practices or regulatory requirements" is admissible to show defendants had the requisite intent and knowledge).

[9] The Defendants do not cite to any case law that supports their contention that an expert can never provide testimony that is probative of a subjective standard of scienter. Rather, the Defendants rely on case law excluding expert testimony on other grounds not argued here. (Defs. Br. at 11-12).

[10] The Defendants misquote Pomerantz. (Defs. Br. at 8 n.1) (citing to Pomerantz Report at ¶¶ 27, 33, 132). Pomerantz never concludes that the Defendants would have discovered Madoff's fraud. Rather, Pomerantz opines that a quantitative analysis would have further confirmed the Defendants' investment accounts with BLMIS contained indicia of fraud. (Pomerantz Report at ¶¶ 27, 33, 132). The Defendants need not have uncovered the Ponzi scheme to have acted with willful blindness here. *Picard v. Katz*, --- B.R. ----, 11 Civ. 03605, 2011 WL 4448638, at *5 (S.D.N.Y. Sept. 27, 2011) ("If an investor . . . intentionally chooses to blind himself to the red flags that suggest a high probability of fraud, his willful blindness to the truth is tantamount to a lack of good faith.") (internal citations omitted).

customs and practices was relevant to show that the defendants knew about the underlying fraud).

C. The Factual Record Corroborates Pomerantz's Testimony

The Defendants assert—without any explanation or specification—that the Reports rely upon incorrect facts and they must be excluded as irrelevant. (Defs. Br. at 1-2, 9-10). Once again they are wrong. The Reports source and rely upon extensive facts and data from the record here. That the Defendants apparently (or may) disagree with certain of Pomerantz's factual premises hardly means the Pomerantz Report is not relevant.[11] In line with the Defendants' own authority, the jury can decide the facts. (Defs. Br. at 10) (citing *Country Road Music, Inc. v. MP3.com, Inc.*, 279 F. Supp. 2d 325, 330-32 (S.D.N.Y. 2003) (expert excluded because his opinions relied on wholly inadequate factual support, not because supporting evidence was in dispute).[12]

To be sure, Pomerantz's factual premises are supported in the record. Moreover, Pomerantz's detailed methodology—which the Defendants do not challenge—explains that in addition to reviewing the evidence in the record, he conducted extensive qualitative and quantitative analyses, the results of which corroborate his Reports' conclusions. This testimony is helpful, relevant, and, thus, admissible. *See Envt'l I*, 2002 WL 31323832, at *3 (expert's testimony that "certain trading patterns would raise red flags, and that [] trading patterns would

[11] *See Daubert*, 509 U.S. at 591 (expert testimony is relevant so long as it relates to any issue in the case); *Pension Comm.*, 691 F. Supp. 2d at 471-72 (expert testimony that relies on factual support from the record was not excluded).

[12] *See also* Fed. R. Evid. 702 advisory committee's note (2000) ("When facts are in dispute, experts sometimes reach different conclusions based on competing versions of the facts. The emphasis in the amendment on 'sufficient facts or data' is not intended to authorize a trial court to exclude an expert's testimony on the ground that the court believes one version of the facts and not the other.").

have raised questions for an experienced trader" is "precisely the type of testimony regarding the practices and usages of a trade" that is helpful and admissible) (internal citations omitted).

II. POMERANTZ'S OPINIONS ARE NOT "LEGAL OPINIONS"

Pomerantz's proposed testimony does not offer any legal conclusions. Experts, of course, can never make legal conclusions. *See Hygh v. Jacobs*, 961 F.2d 359, 363 (2d Cir. 1992). Citing only snippets from Pomerantz's deposition testimony—and not his actual Reports—the Defendants assert that Pomerantz renders conclusions about the Defendants' legal duties to conduct due diligence. (Defs. Br. at 8, 9). This is false.[13] Pomerantz's opinions are about industry customs and practices, not about the Defendants' legal obligations.[14]

Pomerantz can also conclude that the Defendants should have investigated BLMIS further. This line of testimony is not "unfounded." (Defs. Br. at 7-10). Experts routinely opine as to what other parties should have done—pursuant to the relevant industry practices and customs—in response to red flags.[15] *See, e.g.*, *Blech*, 2003 WL 1610775, at *19 ("'[I]t is proper for an expert to testify as to the customs and standards of an industry [with respect to due diligence], and to opine as to how a party's conduct measured up against such standards.'")

[13] The Defendants also mischaracterize Pomerantz's testimony as being "directly contrary" to this Court's observation that "[a] securities investor has no inherent duty to inquire about his stockbroker, and SIPA creates no such duty." (Defs. Br. at 8) (quoting *Picard v. Katz*, --- B.R. ---, 11 Civ. 03605, 2011 WL 4448638, at *5 (S.D.N.Y. Sept. 27, 2011). Pomerantz's Reports and testimony are entirely consistent with this Court's opinion that where, as here, investors like the Defendants have knowledge of many, cumulative red flags indicating a high probability of fraud with their investments, that they cannot deliberately blind themselves to such indicia. *Id.* ("If an investor, nonetheless, intentionally chooses to blind himself to the 'red flags' that suggest a high probability of fraud, his 'willful blindness' to the truth is tantamount to a lack of good faith.").

[14] *See Picard v. Katz, et al.*, Expert Deposition of Dr. Steve Pomerantz, 11 Civ. 03605, dated Jan. 8, 2012, 177:1-178:5; 134:2-10 (hereafter the "Pomerantz Deposition"). The relevant excerpts in the Pomerantz Deposition are Ex. 3 to the Sheehan Decl.

[15] The case law cited by Defendants is of no moment. (Defs. Br. at 7-9). This Court has already determined that the Trustee's Amended Complaint stated a claim against the Defendants.

(quoting *Primavera Familienstiftung v. Askin*, 130 F. Supp. 2d 450, 529 (S.D.N.Y. 2001); *Refco Grp.*, 184 F.R.D. at 631 (expert analysis about how defendants' actions in response to red flags were "inconsistent with industry practices or regulatory requirements" is admissible).

Moreover, the case law cited by Defendants is inapposite. (Defs. Br. at 7-8). Pomerantz never interprets any legal principles. *Cf. Marx & Co. v. The Diners' Club, Inc.*, 550 F.2d 505, 509-10 (2d Cir. 1977). Nor does he use language that tracks any legal test or statute, much less one relevant to the case at bar. *Cf. U.S. v. Scop*, 846 F.2d 135, 140 (2d Cir. 1988). Pomerantz is not telling the jury what result to reach here. *Cf. Hygh*, 961 F.2d at 363-64.

CONCLUSION

For the foregoing reasons, the Trustee respectfully asks this Court to deny the Defendants' Motion.

Dated: New York, New York
February 09, 2012

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