UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES INVESTOR PROTECTION CORPORATION, Plaintiff-Applicant, v. BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Defendant.	Adv. Pro. No. 08-01789 (BRL) SIPA LIQUIDATION (Substantively Consolidated)
In re: BERNARD L. MADOFF, Debtor.	
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. SAUL B. KATZ, *et al.*, Defendants.	Case No. 1:11-cv-03605-JSR Adv. Pro. No. 10-05287 (BRL)

REPLY OF THE
SECURITIES INVESTOR PROTECTION CORPORATION
TO THE AMICUS BRIEF ON "RESET TO ZERO"

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Pursuant to this Court's Order of November 28, 2011, the Securities Investor Protection Corporation ("SIPC") submits this reply to the amicus brief on the "reset to zero" method [Dkt. No. 73] ("Amicus Brief"), filed by certain defendants ("Amicus Defendants") in other adversary proceedings related to the Bernard L. Madoff Investment Securities LLC ("BLMIS") liquidation.

As previously discussed by SIPC,[1] whether transfers in this case were of principal or fictitious profit is relevant to the defense provided in Section 548(c) of the Bankruptcy Code (11 U.S.C.) to an otherwise avoidable fraudulent transfer. In pertinent part, under Section 548(c), a transferee may retain property transferred so long as the transferee "takes for value and in good faith." Under Bankruptcy Code Section 548(d)(2)(A), "value" includes the "satisfaction…of a(n) . . . antecedent debt of the debtor." If a transferee withdrew "principal" from his brokerage account, the withdrawal would be made "for value" because the withdrawal would satisfy BLMIS's obligation to return investment principal on demand. On the other hand, if a transfer was in payment of fictitious profit not owed to the transferee, there would be no antecedent debt, no value provided by the transferee in exchange for the transfer, and hence, no defense to avoidance of the transfer. In sum, the "for value" defense is available only if, and to the extent that, at the time of the transfer, BLMIS held some of the transferee's investment principal, and thus had an "antecedent debt" to the transferee in the amount of that unreturned principal.

The theory concocted by the Amicus Defendants is without precedent or legal support. Amicus Defendants treat "antecedent debt" not as a defense, as they should, but as an absolute right. As an initial matter, their use of the term "reset to zero" is misleading. For no apparent

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[1] Memorandum of Law of the Securities Investor Protection Corporation Regarding Calculation of Fictitious Profits, filed herein on October 25, 2011 [Dkt. No. 61] ("Footnote 6 Brief") and the Reply Memorandum of Law of the Securities Investor Protection Corporation Regarding Calculation of Fictitious Profits, filed herein on November 4, 2011 [Dkt. No. 68] ("Footnote 6 Reply"). SIPC incorporates herein by reference the Footnote 6 Brief and the Footnote 6 Reply.

reason, other than a self-serving one, their approach resets only withdrawals to zero, and not deposits. "Antecedent debt" means money owing to a customer by the debtor. But while recognizing deposits in prior periods, Amicus Defendants ignore all withdrawals in the period immediately preceding the two-year period at issue (the "Two Year Period"), even if the deposit in the Two Year Period, in effect, extinguished a previous debt owing to the debtor by the customer. Amicus Defendants do not point to any support for the proposition that deposits made in the Two Year Period can be "double counted." To the contrary, Amicus Defendants acknowledge that prior to the Two Year Period, the definition of antecedent debt does not change, and any deposit can constitute "antecedent debt" if it meets the requirements of the definition in the Bankruptcy Code. *See* Amicus Brief at 4 ("A 'good-faith' investor *always* has the statutory right to assert 'antecedent debt' as a defense, to show that the investor gave 'fair equivalent value.'" (emphasis in original)).

Effectively, the Amicus Defendants' method creates the fiction that in December 2006, BLMIS absolved all customers of all withdrawals taken prior to December 2006, whether the amounts were of principal or fictitious profit. This principle is illustrated in two of Amicus Defendants' three examples on pages 3-4 of the Amicus Brief. These two examples have been re-charted below using the same numbers provided by Amicus Defendants.

Investor A

	Amount Deposited (Credits)	Amount Withdrawn (Debits)	Net Account Value
1998	$200,000		$200,000
June 2006 (prior to Two Year Period)		$500,000	-$300,000
January 2007 (within Two Year Period)		$100,000	-$400,000
June 2007	$100,000		-$300,000

Fraudulent Transfer - Trustee's Method	$100,000
Fraudulent Transfer – "Reset to Zero"	$0

Investor C

	Amount Deposited (Credits)	Amount Withdrawn (Debits)	Net Account Value
1998	$200,000		$200,000
June 2006 (prior to Two Year Period)		$500,000	-$300,000
January 2007 (within Two Year Period)		$100,000	-$400,000
June 2007	$200,000		-$200,000
After June 2007	$100,000	$100,000	-$200,000[2]

Fraudulent Transfer - Trustee's Method	$200,000
Fraudulent Transfer – "Reset to Zero"	$0

In these examples, Investor A and Investor C each deposited cash with BLMIS during the Two Year Period. The amounts of principal were less than the amounts of fictitious profits that these investors received in previous years. Even though they reflect the payment of fictitious profit, the amounts in the shaded boxes represent the amounts that Amicus Defendants would characterize as "antecedent debt" under 548(c). Yet, these amounts actually *extinguished* a debt owed *by* the customer *to* BLMIS, instead of the reverse.

As previously noted, in calculating antecedent debt, the Amicus Defendants offer no viable support for their theory, or under their theory, for ignoring only withdrawals made in the period preceding the Two Year Period. Under a true "Reset to Zero" theory, deposits, as well as withdrawals, made before the Two Year Period would be ignored. This further points out the absurdity of Amicus Defendants' position. Withdrawals prior to the Two Year Period not only inappropriately would increase the amount of fictitious profit that transferees could retain, as shown above, but investors who actually were owed principal would be deemed instead to owe money to the debtor. To illustrate: a customer who, hypothetically, deposits $1 million prior to

[2] Amicus Defendants characterize Investor C as having "*enriched* the estate by $100,000" even though Investor C actually withdrew $200,000 of other customers' money. *See* Amicus Brief at 4 (emphasis in original).

the Two Year Period, and then withdraws $800,000 in the Two Year period, would receive no credit for the deposit. Instead, if only transactions during the Two Year Period were considered, under a true Reset to Zero approach, the *customer* would owe the estate $800,000, even though, in fact, the $800,000 was in partial payment of the $1 million antecedent debt owed to him. It bears repeating: antecedent debt is the amount of principal owed by the broker to the customer. Unless the entire history of an account is examined, the actual amount owed cannot be determined.

Finally, it is worth noting that under Amicus Defendants' method, in certain examples such as Investor D below, the Trustee would be able to recover *more* from a customer than the Trustee currently is permitted under the Bankruptcy Code.

Investor D

	Amount Deposited (Credits)	Amount Withdrawn (Debits)	Net Account Value
1998	$200,000		$200,000
June 2006 (prior to Two Year Period)		$100,000	$100,000
January 2007 (within Two Year Period)		$500,000	-$400,000
June 2007	$200,000		-$200,000

Fraudulent Transfer - Trustee's Method	$200,000
Fraudulent Transfer – "Reset to Zero"	$300,000

Any customer who withdrew less money than was on deposit with BLMIS prior to the Two Year Period, but ultimately withdrew more than his original investment, like Investor D, would be subject to a higher fraudulent transfer amount under the Amicus Defendants' method.

In short, the Amicus Method favors those customers who withdrew their principal early and were living off of the spoils of the Bernard Madoff fraud. The Amicus Defendants' approach is self-serving, and contrary to applicable law. *See, e.g., Sender v. Buchanan (In re Hedged-Investments Assoc., Inc.)*, 84 F.3d 1286, 1290 (10th Cir. 1996) (holding that because a

victim of a Ponzi scheme did not have an enforceable claim against the debtor for damages in excess of her original investment, the transfers in excess of her investment were not made on account of antecedent debt).

CONCLUSION

For all of the reasons stated above, the "Reset to Zero" approach should be rejected.

Dated: Washington, D.C.
December 6, 2011

Respectfully submitted,

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