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Local firms preparing for new round of Madoff suits

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A number of Boston law firms are bracing for a massive new round of lawsuits in the coming weeks in connection with the Bernard L. Madoff federal bankruptcy case in New York.

Late last month, court-appointed trustee Irving H. Picard told The Wall Street Journal that he may file u to 1,000 new lawsuits against Madoff investors he has defined as "net winners" in an effort to "claw back" payouts they received before Madoff was arrested and his investment company was exposed as a elaborate sham in December 2008.

Lawyers say many of those same investors who were quick to identify themselves early on as "victims" Madoff's scheme may now be the targets of such suits because they took out more money from their Madoff accounts than they put in over the years.

Many of the likely defendants, they say, have previously been sent "soft demand" letters by the trustee that they have either ignored, disputed or intend to challenge legally.

Litigator Jonathan Sablone, who specializes in financial restructuring at Nixon Peabody, said his Bostor firm has "probably dozens" of institutional investors - including charities, insurance companies, foundations and investment funds - as well as well-heeled individual clients who may be sued by Picard in the coming weeks.

Sablone said the firm began preparing for the eventuality about two years ago.

"We've known this was coming since day 1," he said. "One of the first questions we asked them is: ‘Are you a net winner or a net loser?'"

Many thought they were "losers" and initially wanted to sue Madoff, he said, because their account statements showed a fictitional profit that evaporated with his arrest. They reconsidered once it was mac clear that what they believed were lost earnings never existed and that calling attention to how much the withdrew from their accounts could be used against them by the trustee.

"Most people who are not lawyers have a hard time wrapping their minds around this issue," said Sablo of the "net winner" definition that the trustee hopes to use to sort out who he will pursue. "You don't wa to give them a written road map to come after you."

Local bankruptcy attorneys say they expect Picard will likely make good on his threat sometime in the next few weeks and certainly well before the Dec. 10 statutory filing deadline.

He appears to be holding off temporarily until a decision in the Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities LLC comes down from the 2nd U.S. Circuit Court of Appeals over the calculation method the trustee seeks to use to determine how much each investor lost, they say.

Winners and losers

Who is truly a creditor and what are they rightfully owed will come up early as an issue in the impendin suits, said bankruptcy attorney Daniel M. Glosband of Goodwin Procter. "I think that will really be the key issue."

Under the broadest definition of "net winners," Glosband said his firm has "maybe half a dozen" clients who could be part of the trustee's next round of suits. That figure will depend on what happens in the 2n Circuit case, he said, noting that Goodwin Procter is the only Boston firm that has filed briefs on behalf some appellants.

Hundreds have appealed the trustee's assertion that, because it was a Ponzi scheme, investors are due on what they put into their Madoff accounts less what they took out. For those who took out more than they put in, the trustee is attempting to recover the difference between their investments and payouts to help offset losses suffered by those defined as "net losers."

Glosband said many Madoff clients believe the true basis of their investment should be whatever numbe appeared on the final account statements issued to them in November 2008 just prior to Madoff's arrest and that they should be credited with interest.

As of Aug. 10, 2,176 claims totaling $5.57 billion have been allowed, while 11,090 claims have been denied, according to the trustee's website. Approximately $1.5 billion has been recovered as of March 3

The trustee has said he'll draw from these funds to make pro rata distributions to certain customers who have approved claims above the $500,000 maximum payout set by the Securities Investor Protection Corp. sometime before year's end. The amount of allowed claims that exceed the maximum is now $4.8 billion.

Picard said in a "third interim report" issued in April that subsequent payouts will be made to other customers, though the timing and amount depends on a "final resolution" of the net equity issue now before the 2nd Circuit.

Some say given the significance of the case and its effect on future bankruptcies, it is quite possible the battle over the net equity issue may be taken up by the U.S. Supreme Court.

Potential defenses

Richard J. Rosensweig, a securities litigator at Goulston & Storrs, said he expects future defendants will likely mount one of two primary defenses. The "most popular" argument for those who invested money with Madoff a decade or more ago, will be that their true "loss"

equals the amount they invested plus the time value of that money.

The other argument defendants could make, Rosensweig said, is that they invested "in good faith and th had no idea this was a Ponzi scheme." Determining when the scheme precisely began - something the trustee has said he has not been able to nail down - "could come into play" for some defendants if they were made aware of the scheme at some point. Some investors were not especially sophisticated and trusted Madoff without hesitation and without much due diligence.

"They just knew he returned a good profit for them and knew nothing else about it," Rosensweig said.

"I can't tell you the number of people who call and they're just penniless," Sablone said. "They trusted him implicitly."

But ignorance may not provide adequate protection from a lawsuit.

"You should have known these returns were too good to be true,"

Rosensweig said of how Picard could argue in favor of pursuing some of the smaller net worth defendants.

A third position some may take, Rosensweig said, is that New York's six-year claw-back statute should not apply to out-of-state investors and that only the four-year federal limit is applicable.

One aspect that is still unclear but could affect the scope of the claw-back effort, lawyers say, is how aggressively Picard will pursue the so-called "feeder funds" that funneled millions to Madoff, sometime without investors' knowledge. Since many of the funds are based offshore, they are further from the trustee's grasp than U.S.- based investment companies, making it harder to conduct claw backs from tho who invested with Madoff indirectly.

Sablone said Picard has "made noise" that he will pursue offshore investment funds though many of the lost "tons of money" with Madoff, too. Those funds that have settled or are likely to settle with the trust will probably do so in order to then come to the U.S. to pursue their own targets, including brokers, aud companies and others who were complicit in the fraud, he said.

Whatever the end result, Boston attorney Gordon P. Katz said attorneys will look to Madoff in the futur as a blueprint when dealing with similar, large-scale investment frauds.

"It'll be a structural model should other Ponzi schemes like this occur," he said.

Targets unknown

Lawyers say who Picard decides to set his sights on is perhaps the most fascinating unknown right now.

Katz, whose firm Holland & Knight set up a "Madoff Advisory Group" in the wake of the breaking scandal to help clients wade through the mess, said "how far will the trustee go" to recover ill-gotten profits and will he target more Madoff family members or additional feeder funds are critical unanswere questions.

"The targets of the lawsuits will be very interesting and say a lot about his attitude toward some groups of investors," Rosensweig said, noting that the trustee could establish all kinds of parameters to determine who gets sued and who does not, including setting a minimum investment threshold that triggers a suit or avoiding charities and only going after individuals and for-profit companies.

Given the attention the case has drawn and the number of people who were financially devastated by the fraud, Rosensweig speculates Picard will probably bypass smaller claw-back investors who either lost everything or who have little left to repay and instead focus most of his efforts on the big-money defendants.

"He's not going to want to spend too much money chasing very sympathetic defendants who have very modest" means, he said.

"A lot of these people are not going to have the funds to fight these"

lawsuits, Sablone said. "Frankly, even if they can stay afloat, it'll be a miracle."

Glosband said Picard has indicated he will be compassionate. "That remains to be seen."