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The Sad Tale of Multiple Overlapping Fraudulent Transfers: Part IV

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Feature

Four days after Bernard Madoff was arrested, on Dec. 15, 2008, the Securities Investor Protection Corporation (SIPC) obtained a protective order appointing **Irving Picard** as trustee for the liquidation of the Bernard L. Madoff Investment Securities LLC (BLMIS), and the SIPA liquidating proceeding was removed to the U.S. Bankruptcy Court for the Southern District of New York. A controversy of staggering proportions involving statutory interpretation, statutory purpose, the relationship of multiple SIPA[1] and bankruptcy law provisions, and fundamental bankruptcy law philosophy was presented in determining the critical issue: how to define a claimant's "net equity" under SIPA for purposes of distributions for 15,000 claims filed totaling an alleged $73.1 billion.[2]

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On March 1, 2010, the court issued a relatively brief opinion[3] adopting the SIPC position applying a Net Investment Method, based on the total of the investors' original investments less any distributions received. This "cash in/cash out" method reduces the total claims to less than $20 billion,[4] thus creating a corresponding reduction in the SIPC's liability to investors under the securities protection cap of $500,000 per investor by $1.5 billion. The investor claimants, by contrast, based their claims—resulting in the $73.1 billion figure—on their Nov. 30, 2008, BLMIS account statements (the "last statement method").[5]

The Bernard Madoff Ponzi Scheme

BLMIS had two types of Investment Advisory accounts. Some 4,659 investors, or approximately 95 percent, were invested in the Split-Strike Strategy, which generally yielded annual returns of 10-17 percent.[6] Under the Split-Strike Strategy, the BLMIS staff would after the fact select actual trade prices of actual Standard & Poor's 100 Index securities and proportionally distribute the fictional purchase of huge baskets of such securities with favorable performance across all the Split-Strike Accounts.[7] The second type of BLMIS accounts, with 245 investors—which the court described as belonging to "devoted customers" or "family members and employees"—received fictional individual postings of trades in actual securities, again on an after-the-fact basis.[8] The court found that two such investors received returns of 300 percent and 950 percent.[9]

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All of the customers received voluminous paper confirmations of these fictional trades as well as statements at each month end showing their fictional positions.[10] The stock values reported in those confirmations and monthly reports tight actual market pricing.[11]

SIPA Liquidation Proceedings in Madoff

With the entry of the Dec. 15, 2008, protective order, BLMIS was subject to a SIPA liquidation proceeding designed to promptly return customer property.[12] "A proceeding under SIPA essentially is a bankruptcy liquidation remodeled to achieve the special purposes of SIPA."[13] Section 78fff(b) of SIPA provides that a SIPA liquidation proceeding "shall be conducted in accordance with, and as though it were being conducted under

1 Securities Investor Protection Act of 1970.
2 *In re Bernard L. Madoff Inv. Securities LLC (Securities Investor Protection Corporation v. Bernard L. Madoff Investment Securities LLC)*, --- B.R. ---, 2010 WL 694211 at 5 (Bankr. S.D.N.Y. 2010).
3 The court reviewed 30 briefs and more than 20 *pro se* submissions, including briefs by the SIPC and the SEC, and there was oral argument.
4 SIPC Reply Memorandum, Jan. 15, 2010, p. 1.
5 In a unique feature, the court attached as Exhibit A, a 10-page Summary of Arguments, in columnar form, in support of and in opposition to the trustee's positions.
6 *Id.* at 6.
7 *Id.* at 5-6.
8 *Id.* at 6.
9 *Id.*
10 *Id.* at 6-7.
11 *See id.* at 5-6, 13-14.
12 *SIPC v. Barbour*, 421 U.S. 412, 416 (1975).
13 *Hill v. Spencel S&L Ass'n (In re Bevill, Bresler & Schulman Inc.)*, 83 B.R. 880, 886 (D. N.J. 1988); *Exchange National Bank of Chicago v. Wyatt*, 517 F.2d 453, 457-59 (2d Cir. 1975).

chapters 1, 3, 5 and subchapters I and II of Chapter 7 of title 11" to the extent that such provisions are consistent with SIPA.[14] Where SIPA is inconsistent with the Bankruptcy Code, however, the specific provisions of SIPA control.[15]

In a SIPC liquidation, the property recovered by the trustee is to be shared by customer claimants on a *pro rata* basis.[16] Because of delays in collecting property and funds, SIPC is to advance funds to those customers "up to the lesser of their Net Equity claims or the dollar limits set out in the Act."[17] The claim limits are $500,000 for securities and $100,000 for cash in a customer's account.[18] SIPC retains a right of subrogation against these advances should the customer's net equity claim eventually be paid in full.[19] SIPC takes the position that it is entitled to such subrogation not when all customers' claims are paid, but at such time as a specific customer alone is fully satisfied.[20] As of March 22, 2010, the SIPC had "committed" to payment of $664,181,100 in Madoff claims.[21]

In the contentious battles between the net-investment and last-statement methods, the trustee refers to "net winners" as "customers who received a full return of their principal investment as well as some return beyond their principal investment."[22] Net winners adamantly disagree with the net-investment method because under its formula, they have zero net equity and thus no allowed claim, whereas under the last-statement method, they could be compensated (*pro rata* with other investors) for amounts reflected on their account balances. The difference not only changes the relative amounts received among claimants, but the last-statement method also drastically increases the amount owed by SIPC. One brief offers a specific example illustrating the difference between the net-investment and last-statement methods: Judith Rock Goldman, a 67-year-old New York City public school teacher, opened an account in 1992, and over the years invested a total of $49,378. Her last statement showed $213,900. Under the net-investment method, however her "net equity" would be $49,378.[23]

The March 1, 2010, Opinion

Judge **Burton Lifland** ruled that the plain language and legislative history support the net-investment method.[24] More specifically, he stated that "the definition of Net Equity under SIPA section 78lll(11) must be read in tandem with SIPA section 78fff-2(b), which requires the trustee to discharge Net Equity claims only insofar as such obligations are ascertainable from the books and records of the debtor…."[25] Because the "BLMIS books and records expose a Ponzi scheme where no securities were ever ordered, paid for or acquired...the only verifiable amounts that are manifest from the books and records are the cash deposits and withdrawals."[26]

The opinion also rationalizes that the net-investment method is consistent with bankruptcy avoidance powers.[27] Although the court declined to decide any issues surrounding avoidance, it did note that (1) "SIPA and the Code intersect to, *inter alia,* grant a SIPA trustee the power to avoid fraudulent transfers for the benefit of customers"[28] and (2) the net-investment method harmonizes the definition of net equity with the avoidance provisions of the Bankruptcy Code by "similarly discrediting transfers of purely fictitious amounts and unwinding, rather than legitimizing, the fraudulent scheme."[29] The opinion argues that the last-statement method, by contrast, would base distributions to customers "on the very fictitious transfers the trustee has power to avoid."[30]

Although the trustee and net winners both cite to *In re New Times Securities Services Inc.* and *New Age Financial Services Inc.,* 371 F.3d 68 (2d Cir. 2004) (*New Times I*) in support of their net-equity positions, the court sided with the trustee.[31] *New Times I* was a SIPA liquidation involving a Ponzi scheme where investors were fraudulently induced to purchase securities.[32] "The securities intended to be purchased included (1) nonexistent money market funds and (2) shares of bona fide mutual funds."[33] As with BLMIS, customer funds were not invested and bogus confirmations and fake monthly account statements were issued.[34] The trustee in *New Times I* treated claimants whose account statements confirmed that they were invested in bona fide securities favorably while limiting the potential recovery of claimants that invested in the bogus money market funds.[35] The Second Circuit ultimately found that customers invested in the fictitious securities would have claims limited to the net cash invested in the scheme and should "not include the artificial interest or dividend reinvestments reflected in the fictitious account statements."[36]

In favoring the trustee's position, Judge Lifland determined that Madoff's customers were more like the investors in *New Times I* who received fake securities as opposed to those who thought they were invested in real securities.[37] The court supports its decision as equitable, *citing Cunningham v. Brown,* 265 U.S. 1, 12 (1924), for the position that "equality is equity."[38] The court was concerned that the last-statement method would "make the trustee perpetrate his own Ponzi scheme, because the net winners would again receive money put into the scheme by the net losers."[39]

Definition of "Net Equity" in the Statute

The central inquiry begins with the "net equity" definition in the statute. Plain meaning should be conclusive, and recent Supreme Court cases have stressed the applicability of the plain meaning rule to construction of statutes in bankruptcy cases.[40] A customer's "net equity" claim is the "dollar amount" that would result if the broker had "liquidated [the customer's securities positions] by sale or purchase on the filing date," less any indebtedness of such customer to the debtor.[41] Courts are to construe SIPA liberally to effectuate its remedial purpose of customer protection.[42] Claimants additionally argue that the SIPC is prohibited from changing this definition under §78ccc(b)(4)(A) by adoption of a "cash in/cash out" rule.

Congress enacted SIPA in 1970 for the primary purpose of protecting customers from losses caused by the insolvency or financial instability of broker-dealers[43] and "in response to a

14 *See* 15 U.S.C. §78fff(b) (hereinafter SIPA will be cited without reference to 15 U.S.C.); *In re Adler Coleman Clearing Corp.*, 198 B.R. 70, 74 (Bankr. S.D.N.Y. 1996).
15 §78fff(b).
16 §78fff-2(c)(1)(B).
17 Trustee's Memorandum of Law, Oct. 16, 2009, p. 25.
18 §78fff-3(a).
19 Id.
20 SIPC Reply Memorandum, Jan. 15, 2010, p. 14.
21 See www.madofftrustee.com, albeit these funds are only "committed" and not actually paid, contradicting the SIPA directive of "prompt" payment.
22 2010 WL 694211 at 7.
23 Milberg LLP Memorandum of Law, Nov. 13, 2009, p. 11.

24 2010 WL 694211 at 9.
25 *Id.* at 10.
26 *Id.*
27 *Id.*
28 *Id.*
29 *Id.*
30 *Id.*
31 *Id.* at 13.
32 371 F.3d 68 at 71-2.
33 *Id.* at 72.
34 *Id.* at 74.

35 *Id.*
36 *Id.* at 88.
37 2010 WL 694211 at 13-4.
38 *Id.* at 15.
39 *Id.* at 16.
40 *Knox v. Agria Corp.*, 613 F.Supp.2d 419, 421 (S.D.N.Y. 2009); *In re Chateaugay Corp.*, 920 F.2d 183, 184 (2d Cir. 1990) (quoting *United States v. Ron Pair Enters. Inc.*, 489 U.S. 235 (1989); *Lamie v. U.S. Trustee*, 540 U.S. 526, 538 (2004).
41 §78lll(11).
42 *In re New Times Secs. Servs.*, 371 F.2d 68, 84 (2d Cir. 2004); *Appleton v. First Nat'l Bank*, 62 F.3d 791, 801 (6th Cir. 1995).
43 *See SEC v. S.J. Salmon & Co. Inc.*, 375 F.Supp. 867, 871 (S.D.N.Y. 1974).

'rash of failures among securities broker-dealers in the late 1960's.'"[44] One of the major problems SIPA was intended to solve was the huge back office failures to process securities paperwork and delivery of certificates. Under new procedures, securities could be held in street name by the brokerage houses.[45] Congress sought to "reinforce the confidence that investors [had] in the U.S. securities markets" and "strengthen...the financial responsibilities of broker-dealers."[46] The financial-services industry was the main beneficiary of the enactment of SIPA, as it helped restore investor confidence.

In 1978, SIPA was amended to state that "[t]he trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities."[47] Thus, delivery of traded securities through purchase was the preferred method for satisfaction of customer claims, as opposed to cash payments. The purpose of this enactment was the failure of prior law "to meet legitimate customer expectations of receiving what was in their account at the time of their broker's insolvency."[48] Both the Senate and House Reports on the 1978 amendments make clear that the law is to cover customers' securities, notwithstanding the fact that such securities may be "hypothecated, misappropriated, *never purchased*, or even stolen...."[49]

As claimants repeatedly point out, Steven Harbeck, president of the SIPC, testified in the *New Times* case that SIPC covers appreciation in customer accounts and securities missing from accounts, "even if they're not there...[and even if] the securities were never purchased... we will gladly give the people their securities positions."[50] In addition, in its brief in *New Times,* the SIPC stated: "[R]easonable and legitimate claimant expectations on the filing date are controlling even where inconsistent with transactional reality."[51]

SIPC Changes Rules and Forms

Claimants point out that the new "cash in/cash out" rule is inconsistent with prior SIPC practice.[52] In the past, the SIPC claim was based on the last brokerage statement:

> In the unlikely event your brokerage firm fails, you will need to prove that cash and/or securities are owed to you. This is easily done with a copy of your most recent statement and transaction records of the items bought or sold after the statement.[53]

Nothing in this SIPC language states that investments are added up and reduced by distributions. In addition, after the Madoff case was filed, the SIPC changed its claims forms to adopt the cash in/cash out approach. As stated by Steven Harbeck in January 2009:

> We've modified our usual claim form to ask investors a question that's unique to this case, which is how much money did you put in and how much money did you take out.[54]

No case law supports awarding investors in Ponzi schemes for false profits never earned. Once the outcome departs from the statutory language, however, it is not possible to do equity without consideration of the time value of the funds invested.

Time Value of Money

Perceived objectively, the adoption of the net-investment method is simply a raw exercise of the adoption of a supposedly equitable calculation to compute the SIPC's "net equity" obligation. It is founded on an inapplicable reference to *Cunningham v. Brown*[55] for the proposition that "equality is equity." While such language was used, *Cunningham* merely enforced the language of bankruptcy preference statutes over prior mechanical rules of tracing proceeds in the fraudster's bank accounts.[56] Certainly, in more recent years, the Supreme Court has taken a much narrower view of the use of equity,[57] and that is especially so with respect to the equitable powers of a bankruptcy court, especially with regard to §105 of the Code.[58] Nevertheless, the question is whether adoption of such a rule is fair and equitable.

As stated by Learned Hand: "Whatever may have been our archaic notions about interest, in modern financial communities a dollar today is worth more than a dollar next year, and to ignore the interval as immaterial is to contradict well-settled beliefs about value."[59] As more recently stated by Judge **John Ninfo**, in *In re Unified Commercial Capital Inc.,* (Bankr. W.D.N.Y. 2001), approving the retention of reasonable interest received by a Ponzi scheme investor, it would be an injustice to ignore "the universally accepted fundamental commercial principle that, when you loan an entity money for a period of time in good faith, you have given value and are entitled to a reasonable return."[60]

As such, it would be inexcusable to adopt a supposedly equitable formula—where investors who have invested money with Madoff for years, and some for decades—and to ignore the time value of money. The SEC has likewise noted this concern, but has not yet formally filed a position on the issue.[61] The trustee attempted to deflect this issue in its brief by claiming that the interest issue "is not before the Court in this briefing."[62] It can make no claim that this factor should not be considered.

Numerous federal courts have noted and discussed this issue in-depth over many decades.[63] New York law generally has a mandatory award of prejudgment interest in damage cases. NY CLS CPLR §5004 (2010) provides for a 9 percent rate. The specific rate to apply is a more difficult issue: (a) a statutory rate such as 6, 9 or 10 percent seems high; (b) a Fed Funds or Treasury Rate seems moderate; or (c) simply a consumer price index or inflation rate could provide a base. Undoubtedly, the trustee and the SIPC are concerned that awarding claimants the full last-statement amount disproportionately awards far too much to early investors who have allegedly reaped the benefit of

44 371 F.3d 68 at 84 (quoting *SEC Investor Prot. Corp v. BDO Seidman LLP*, 222 F.3d 63, 66 (2d Cir. 2000) and H.R. REP NO. 91-1613 at 2-4 (1970), *reprinted in* 1970 U.S.C.C.A.N. 5254, 5257).
45 SIPC Memorandum, Oct. 16, 2009, pp. 8-9.
46 H.R. Rep. No. 91-1613 at 2-4 (1970), *reprinted in* 1970 U.S.C.C.A.N. 5254, 5257.
47 §78fff-2(d).
48 D 922 Cong. Rec. H. 363226 (daily ed. Nov. 1, 1977).
49 S. Rep. No. 95-763, at 2 (1978); H.R. Rep. No. 95-746 at 21 (emphasis added).
50 Hearing Transcript at 37-38, *In re New Times Sec. Servs. Inc.*, 371 F.3d 68 (Bankr. E.D.N.Y. 2000).
51 Brief of Appellant SIPC, available at 2005 WL 5338148 (Dec. 27, 2005) at 23-24.
52 *See, e.g.*, Bernfeld, Dematteo & Bernfeld LLP Memorandum of Law, Nov. 13, 2009, p. 20-3.
53 *See* SIPC/SIFMA brochure, Understanding Your Brokerage Account Statements, at 5, SIPC Web site 2009.
54 Jan. 6, 2009, CNBC; *see also* Jan. 5, 2009, Harbeck Testimony before House Financial Services Committee.
55 *Supra.*
56 265 U.S. at 10-1.
57 *See, e.g., Grupo Mexicano de Desarroll SA v. Alliance Bond Fund Inc.*, 527 U.S. 308 (1999).
58 *New England Dairies Inc. v. Dairy Mart Convenience Stores Inc. (In re Dairy Mart Convenience Stores Inc.)*, 351 F.3d 86, 92 (2d Cir. 2003).
59 *Procter & Gamble Distribution Co. v. Sherman*, 2 F.2d 165, 166 (S.D.N.Y. 1924).
60 260 B.R. 343 at 351-52.
61 SEC Memorandum of Law in Support of Trustee's Position, Dec. 11, 2009, p. 1.
62 Trustee Memorandum of Law, Oct. 16, 2009, p. 53.
63 *See, e.g., In re Oil Spill by the Amoco Cadiz off the Cost of France on March 16, 1978*, 954 F.2d 1279, 1335 (7th Cir 1992).

overly high fictional appreciation, taking their account values beyond what would reasonably have accrued in an average stock fund or index fund.[64] Nevertheless, to go to the opposite extreme and to ignore any appreciation in investments over decades does no equity whatever.

Reading Statutes in Tandem

In reaching his "net equity" conclusion, Judge Lifland found that it is necessary to read the "net equity" definition in tandem with both (1) a review of the obligations ascertainable from the books and records of the debtor under §78fff-2(b), and (2) consistency with the trustee's avoidance powers by "discrediting transfers of purely fictitious amounts and unwinding, rather than legitimizing, the fraudulent scheme."[65]

First, the examination of the debtor's books and records should always reveal that the fraudulent debtor kept two sets of books: (1) one showing the statements sent to the customers, and (2) the real asset position. Thus, by looking at the books and records, the trustee always has a choice. By always selecting the second set of books, which show that the customers have nothing, only the smallest amount would ever be paid, and customers would have no protections consistent with SIPA purposes or congressional intent to cover customer's expectations. That is, if the asset isn't really there, the customer won't recover.

Guilty until Proven Innocent

Second, with the adoption of the "cash in/cash out" method, the trustee necessarily concludes that every payment to an investor was necessarily a fraudulent transfer within the meaning of the Bankruptcy Code or state law, even if the transfers are beyond the federal two-year statute of limitations. In fact, by this theory, no statute of limitations would apply and payments made 20 or 25 years ago would be deducted.

This is not merely an adoption, as Judge Lifland suggests, of *Manhattan Inv. Fund Ltd.*[66] and *Bayou Superfund LLC v. WAM Long/Short Fund, II LP,*[67] and their presumption that a Ponzi scheme by its own nature creates a presumption of an intent to hinder, delay or defraud for the purposes of §548(a)(1)(A); rather, it amounts to giving the trustee a free pass as to (a) the good-faith and for-value defenses under §548(c), as well as (b) the statute of limitations in §546(a)(1).[68]

While the Second Circuit in *New Times I* affirms the net investment rule for only those customers whose funds were invested in wholly fictional mutual funds, it does not discuss any offset or fraudulent-transfer reduction. It merely concludes that "we adopted the view that the Claimants' net equity is properly calculated as the amount of money that the Claimants initially placed with the debtors…."[69] No mention is made of any reduction.

New Times I *Support for the Parties' Positions*

As Judge Lifland notes, both sides of this controversy rely heavily on *New Times I.*[70] The opinion and the SIPC rely on its language, refusing to accept the last-statement method for those investors whose funds were in fictional investments.[71] Conversely, the investors point out that ostensible purchases of shares of Vanguard and Putnam funds in *New Times I* is no different from ostensible purchases of shares of Microsoft and General Electric by BLMIS.[72] Neither of the purchases occurred, but in *New Times* the investors in real funds were paid based on their last statements. By contrast, as to the investors in fictional mutual funds, *New Times* pointed out: "To be clear—and this is the crucial fact in this case—the New Age Funds in which the Claimants invested never existed."[73] In *Madoff,* Microsoft and General Electric do exist. Neither the opinion nor the briefs of the SIPC or the trustee offer to explain why the SIPC has not simply purchased for the investors the securities shown on the final statements in accordance under the mandatory directive of §78fff-2(d).

That said, it is also a fair statement that *New Times I* appears to assume that the customers whose funds were fictionally invested in real mutual funds experienced appreciation of such funds in accordance with normal market fluctuations. By contrast, the whole thrust of the trustee's and the SIPC's position is that the Madoff investors are akin to those *New Times* investors in the fictional funds, because all appreciation shown on the Madoff accounts was created by after-the-fact fictional manipulation of account statements, rather than actual market conditions.[74] Thus, the *Madoff* fact pattern presents a case of first impression to the Second Circuit.

Lack of Factual Findings

An overall review of the parties' briefs and the court's opinion suggests that the parties' and court's positions seem long on theory and short on facts. For example, while the court and SIPC may refer to the 245 claimants as family and friends and attribute exorbitant investment returns to such accounts,[75] the investors' briefs suggest that these are two limited and extreme examples.[76] Possibly, those two investors are subject to *bona fide* fraudulent-transfer claims, which would not only reduce their claim amounts, but subject them to substantial disgorgement in favor of the estate. In sum, the broad philosophy applied by the court and parties may exceed the specific factual issues once they are determined.

Class Action against SIPC Officers and Directors

In a seemingly extraordinary move, a class action has been filed against Stephen Harbeck and the board of directors of SIPC alleging breaches of fiduciary duty.[77] The most serious allegations relating to the SIPC serving as an industry factotum rather than upholding its fiduciary duty to investors are: (1) the SIPC's assessment for a period of 19 years of $150 per year as its charge per investment broker member, notwithstanding the size of the entity charged;[78] and (2) that in April of 2003, the SEC found that the SIPC fund was at risk of failure in the event of the liquidation of one or more large securities firms, and that even if it were to triple the fund in size, a very large liquidation would deplete the fund.[79] "The SEC suggested that SIPC examine alternative strategies for dealing with the costs of such a large liquidation."[80] Yet no action was taken, and the "very large liquidation" foreseen by the SEC has come to pass.[81] In response to this grave underfunding, the suit alleges that

64 SIPC Reply Memorandum, Jan. 15, 2010, pp. 19-20.
65 2010 WL 694211 at 10-11.
66 397 B.R. 1, 8 (S.D.N.Y. 2007).
67 *In re Bayou Group LLC*, 362 B.R. 624, 634 (Bankr. S.D.N.Y. 2007).

68 As suggested in claimants' briefs, investors may have sought distributions to pay taxes, or simply to comply with law requiring distributions to be received from retirement accounts after an investor reaches the age of 70. *See, e.g.,* Bernfeld, Dematteo & Bernfeld, LLP Memorandum of Law, Nov. 13, 2009, p. 29. Even if one were to adopt the overly narrow and arguably incorrect definition of "good faith" found by the court in *In re Bayou Group LLC*, 396 B.R. 810 (Bankr. S.D.N.Y. 2008), that opinion nevertheless adopts a broad range of good-faith reasons for withdrawal of funds. *See* 396 B.R. at 853-54 for list of seven good-faith reasons.
69 371 F.3d at 88.
70 2010 WL 694211 at 13.
71 *Id.* at 13; SIPC Memorandum, Oct. 16, 2009, pp. 20-22.
72 *See, e.g.*, Davis Polk & Wardwell LLP Memorandum of Law, Nov. 12, 2009, pp. 3-6.
73 371 F.3d at 74.

74 *See, e.g.*, Trustee Memorandum, Oct. 16, 2009, pp. 38-9.
75 *See, e.g.*, 2010 WL 694211 at 4, 6.
76 *See, e.g.*, Milberg LLP Memorandum of Law, Nov. 13, 2009, p. 7.
77 *Canavan v. Harbeck*, Case 2:10-cv-00954-FSH-PS, complaint filed on Feb. 24, 2010 (D. N.J. 2010).
78 *Id.* at ¶¶54 and 77.
79 *Id.* at ¶88; July 2003 United States Accounting Office Report to Congressional Requesters, "Securities Investor Protection: Update on Matters Related to the Securities Investor Protection Corporation."
80 *Id.*
81 *Id.* at ¶89.

SIPC is now changing the positions it has taken for decades to drastically short customer protection because of the lack of funds to pay these claims.[82]

Conclusion

Courts should be wary of going beyond the statutory definition of "net equity" by adopting a definition that finds no basis in the statutory language or history. This is particularly so where such adoption would limit the scope of investor protection, which courts have said should be broadly construed. Reading the "net equity" definition in conjunction with (a) the review of the broker's books and records provision and (b) the SIPC trustee's statutory powers to bring avoidance actions have no sound basis in case law or theory.

Applying the definition of "net equity" to a fact pattern that has been pervaded with fraudulent, fictitious and inflated returns for many years exceeds any common-sense method of customer protection. No case law supports awarding investors in Ponzi schemes for false profits never earned. Once the outcome departs from the statutory language, however, it is not possible to do equity without consideration of the time value of the funds invested. But some courts would consider adopting a "cash in/cash out" method—even with an interest component—to be changing statutory language without congressional approval. ■

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82 *Id.* at ¶144.