

Madoff-Related Litigation

Going After Money That's No Longer There

By: Jeff Nielsen
Managing Director

On December 11, 2008, Bernard L. Madoff, an iconic money manager, made a stunning admission to federal authorities: his storied and secretive investment advisory business was in reality a decades-long, \$50 billion Ponzi scheme (later increased to \$65 billion). Lives changed overnight. From close associates of Madoff to sophisticated institutional investors, incomprehensible losses soon came into focus.

It was only a matter of hours before the first lawsuit was filed. By April 30, 2009, 75 separate suits had been filed, with additional lawsuits continuing to mount.

The litigation emanating from the global credit crisis has been unprecedented. In separate research, we have tracked and reported on 866 credit crisis-related cases filed in U.S. federal courts over the two years ended December 31, 2008.¹ By comparison, the Resolution Trust Corporation, the federal agency charged with clean-

ing-up the U.S. savings-and-loan crisis, handled a total of 559 cases over its entire six-year existence.

The Madoff-related litigation constitutes a separate chapter in the litigation fallout from the global credit crisis.² While the ultimate investment losses borne by Madoff's clients were inevitable (as is the case with all Ponzi schemes), their realization was dramatically accelerated as rapidly deteriorating market conditions led to a heightened level of redemptions. As Warren Buffett famously remarked, it's only when the tide goes out that you see who's been swimming naked. The credit crisis caused the tide to go out on Madoff.

In this paper, we briefly summarize: the volume of Madoff-related filings, the types of plaintiffs bringing the suits, the types of defendants named, the U.S. courts in which these cases have most frequently been filed, and specific counts alleged.



Through April 30, 2009, we identified 75 Madoff-related matters filed in both U.S. federal and state courts (approximately two-thirds of these cases were filed in federal court). See Figure 1. Fifty-four of these matters (72 percent) were filed over the three months from February to April 2009.

Virtually all of the lawsuits to date have been brought by investors. These include investor class actions³ (43 percent), suits brought by institutional investors (24 percent), and suits brought by individual investors⁴ (17 percent). Shareholder derivative suits account for another seven percent. Civil cases filed by federal or state regulatory

agencies likewise make up seven percent. See Figure 2.

More recently, Irving H. Picard, the liquidation trustee (under the Securities Investor Protection Act) for Bernard L. Madoff Investment Securities LLC (BLMIS), has filed highly-publicized lawsuits seeking to “claw back” funds distributed to and/or redeemed by certain Madoff clients, the first of which was filed in April 2009. These transactions include alleged preferential transfers – generally occurring within 90 days of the December 11, 2008 bankruptcy filing – which effectively benefited some investors over others. Mr. Picard is also seeking to recover

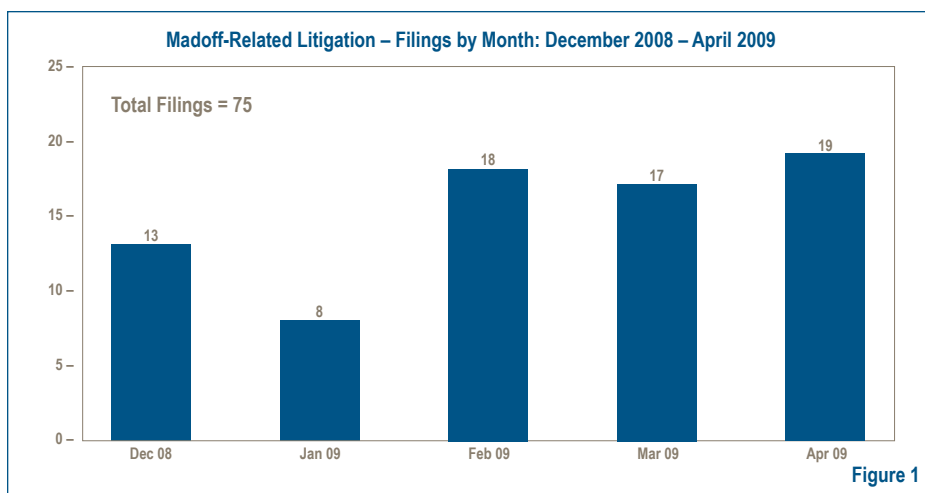


Figure 1

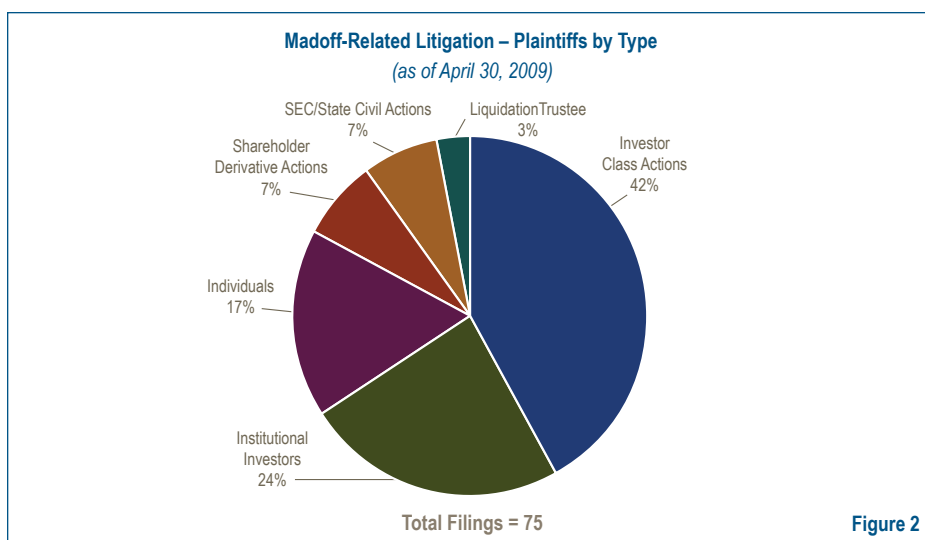


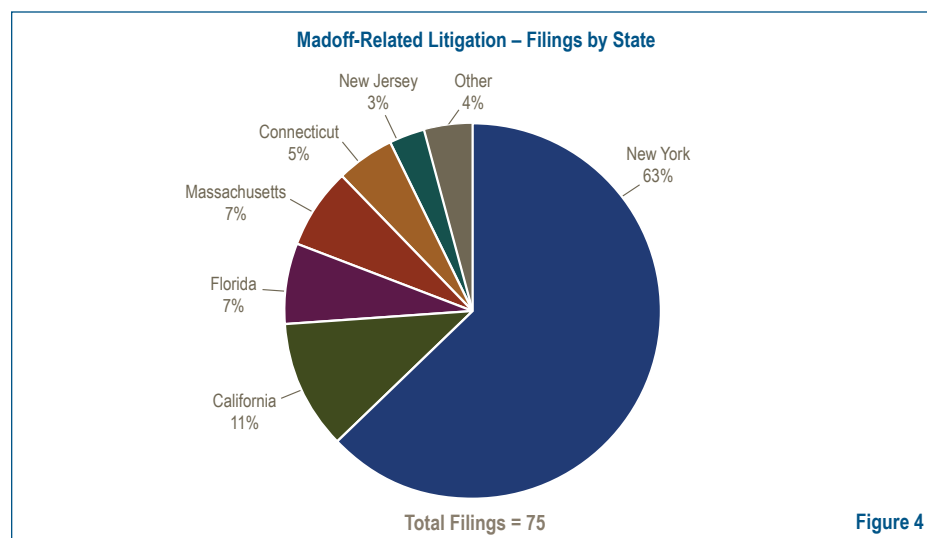
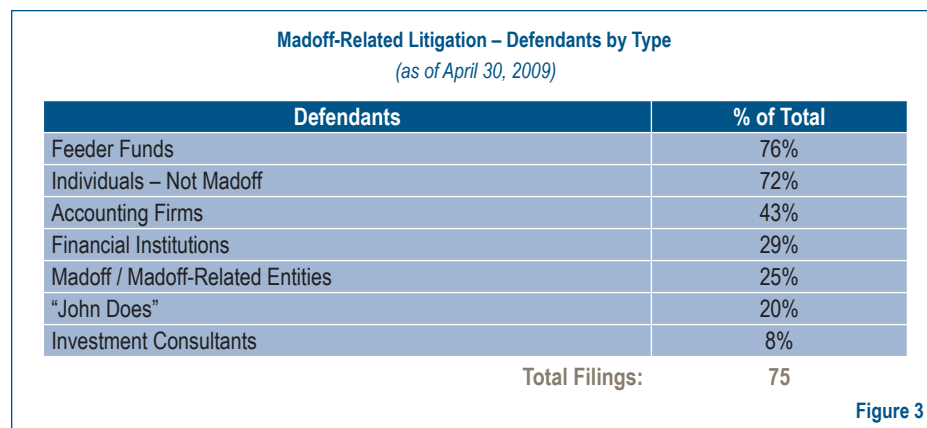
Figure 2

funds distributed to and/or redeemed by certain investors, claiming fraudulent transfers, as far back as six years from the bankruptcy filing. As of the time of this writing, Mr. Picard has filed six lawsuits seeking approximately \$10 billion in such claw backs.⁵

Named defendants have been numerous. Various feeder funds, which assisted in one form or another in funneling client monies to Madoff, are named in 76 percent of the cases. Accounting firms, generally serving as external auditors for the feeder funds, appear as defendants in 43 percent of the matters. Several of the accounting firms are named in multiple cases, including three of the “Big 4” accounting firms being named in more than 20 percent of the cases. Frie-

hling & Horowitz PC, the firm ostensibly responsible for auditing Madoff’s books, is a named defendant in a handful of matters.⁶ Financial institutions, most often servicing as custodians, fund administrators or prime brokers, were named in 29 percent of the cases filed. Madoff himself, or Madoff-related entities,⁷ were named as defendants in 25 percent of the cases. Investment consultants were named in eight percent of the cases. Individuals (other than Madoff) were named in 72 percent of cases. *See Figure 3.*

Sixty-three percent of the matters have been filed in New York courts. The next most frequent jurisdictions are California, Florida, and Massachusetts. *See Figure 4.*



Jeff Nielsen is a Managing Director in the Washington, DC office of Navigant Consulting, Inc. where he leads the firm's Financial Services Disputes & Investigations service line. For more than 15 years, Mr. Nielsen has advised clients on the financial, economic, accounting and information management aspects of commercial disputes and regulatory investigations, specifically matters involving the financial services industry. Mr. Nielsen is currently leading a number of the firm's major credit crisis-related engagements. He is a frequent speaker on securities and mortgage-related issues and has been quoted, or has had his work cited, in *The Wall Street Journal*, *The New York Times*, *The Economist*, as well as other publications.

Specific counts alleged and their relative frequencies are broken out for each of the following categories of defendants: feeder funds, accounting firms, Madoff and related entities, and financial institutions. *See Figures 5-8.*

Mr. Picard has to date secured more than \$1 billion from Madoff or the entities he controlled and, as noted above, is seeking to claw back additional funds from investors. These recoveries, however, represent only a fraction of the overall investor losses. At this

point, the most significant potential residual exposure to the Madoff fraud would appear to reside with various intermediaries/third parties (including insurers) and clients who successfully extracted funds from BLMIS. Over time, how these suits get resolved will address the vexing question of who if anyone should pay (and how much) when the money is gone.

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Feeder Funds: Specific Counts Alleged

(as of April 30, 2009)

Counts	% of Total
Breach of Fiduciary Duty	81%
Unjust Enrichment	58%
Negligent Misrepresentation	47%
Breach of Contract	39%
Aiding and Abetting	33%
Negligence	28%
Gross Negligence	26%
Total Filings:	57

Note: Reflects all cases filed from December 2008 – April 2009, to the extent complaints were available. Includes counts alleged against co-defendants.

Figure 5

Accounting Firms: Specific Counts Alleged

(as of April 30, 2009)

Counts	% of Total
Breach of Fiduciary Duty	81%
Unjust Enrichment	66%
Negligent Misrepresentation	50%
Gross Negligence	41%
Aiding and Abetting	38%
Total Filings:	32

Note: Reflects all cases filed from December 2008 – April 2009, to the extent complaints were available. Includes counts alleged against co-defendants.

Figure 6

About Navigant Consulting, Inc.

Navigant Consulting, Inc. (NYSE: NCI) is a specialized independent consulting firm providing dispute, financial, investigative, regulatory and operations advisory services to government agencies, legal counsel and large companies facing the challenges of uncertainty, risk, distress and significant change. The Company focuses on industries undergoing substantial regulatory or structural change and on the issues driving these transformations.

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Madoff and Related Entities: Specific Counts Alleged

(as of April 30, 2009)

Counts	% of Total
Breach of Fiduciary Duty	53%
'34 Act – Manipulative and Deceptive and Contrivances, § 10(b) & Rule 10(b)(5)	37%
Negligent Misrepresentation	26%
Unjust Enrichment	26%
'34 Act – Joint & Several Liability, § 20(a)	21%
Total Filings:	19

Legend: '34 Act – Securities and Exchange Act of 1934

Note: Reflects all cases filed from December 2008 – April 2009, to the extent complaints were available. Includes counts alleged against co-defendants.

Figure 7

Financial Institutions: Specific Counts Alleged

(as of April 30, 2009)

Counts	% of Total
Breach of Fiduciary Duty	69%
Unjust Enrichment	50%
Negligent Misrepresentation	44%
Aiding and Abetting	38%
Breach of Contract	38%
Gross Negligence	38%
Total Filings:	16

Note: Reflects all cases filed from December 2008 – April 2009, to the extent complaints were available. Includes counts alleged against co-defendants.

Figure 8

- Nielsen, Jeff, Scott Paczosa, and William Schoeffler, "Subprime Mortgage and Related Litigation – 2008: Seeking Relief," Navigant Consulting, Inc. (March 2009).
- The Madoff-related cases are not included among the 866 matters referenced earlier.
- An institutional investor was a named lead plaintiff in 41 percent of the investor class actions.
- Includes two living trusts.
- Four of these matters (representing the majority of the \$10 billion) were filed in the first few weeks of May 2009.
- To date, David Friehling is the only individual other than Madoff to be criminally charged.
- This category includes Madoff family members as well as BLMIS, Madoff Securities International Ltd., and Cohmad Securities Corporation.

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