EXHIBIT B

May 1, 2009

David Becker, Esq.
General Counsel and Senior Policy Director
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Madoff Securities SIPA Proceeding

Dear Mr. Becker:

We write on behalf of customers of Bernard L. Madoff Investment Securities LLC ("Madoff Securities" or "Madoff"), a debtor in a proceeding under the Securities Investor Protection Act ("SIPA"), to respectfully request that the Securities and Exchange Commission ("SEC") exercise its plenary authority to supervise the Securities Investor Protection Corporation ("SIPC") with respect to one of the most important and central issues in the Madoff SIPC proceeding: the calculation of customers' net equity claims.[1]

SIPA states that a customer's net equity claim is the value of the "securities positions" in her account as of the filing date of the SIPA liquidation, less any amount the customer owes the debtor as of that date. In this case, the Madoff Trustee (the "Trustee") has taken a contrary position. He contends that the customers' net equity claims are to be determined by netting the total deposits against total withdrawals in their accounts since inception. As explained in this letter, while such a "cash in, cash out" valuation methodology can be appropriate in circumstances where the securities the broker-dealer had purportedly purchased were "fictitious" (i.e., non-existent securities that could never be purchased), it is entirely improper in circumstances where the securities purportedly purchased were "real" (i.e., actual securities that exist and could have been purchased). In taking this "cash in, cash out" netting position in the Madoff case – which involved purported purchases of "real" securities – the Trustee is advocating an approach that is contrary to (1) the statutory definition of "net equity" in SIPA, (2) the legislative history and intent of SIPA, (3) SIPC precedent, and (4) the leading Second Circuit authority on this issue.

In addition to being wrong as a matter of law, the Trustee's position raises significant policy questions. Not only would it impair the claims of thousands of Madoff Securities customers, it would also radically alter the perception of securities investors everywhere as to what SIPC protection means. The

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[1] As the Supreme Court stated in *Securities Investor Protection Corporation v. Barbour*, SIPA invests the SEC with "'plenary authority' to supervise the SIPC." 421 U.S. 412, 417 (1975) (citing SIPA's legislative history); *see also In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 77 (2d Cir. 2004) (citing SIPA's legislative history and other case law evidencing the SEC's "substantial" oversight authority with respect to SIPC).

consequence of such a changed perception would be to further erode investor confidence at a time when the securities industry and markets can least afford it.

Finally, given the July 2, 2009 bar date in this case, as well as the fact that many Madoff customers are currently in the process of considering or entering into settlements (with accompanying releases) with the Trustee based on the Trustee's incorrect statement of the law, this is an extremely time sensitive matter. Inaction on this issue will likely result in irreparable injury to hundreds, if not thousands, of customers.

1. The Trustee's View of "Net Equity" Is Directly At Odds with SIPA

SIPA defines a customer's net equity claim as the value of the customer's "securities positions" in her account, less any amount the customer owes the debtor, as of the date of the filing of the SIPA liquidation:

> "The term 'net equity' means the dollar amount of the account or accounts of a customer, to be determined by –
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> (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer . . .; minus
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> (B) any indebtedness of such customer to the debtor on the filing date . . ."[2]

15 U.S.C. § 78lll(11); *see also In re Adler Coleman Clearing Corp.,* 247 B.R. 51, 62 n.2 (Bankr. S.D.N.Y. 1999) ("'Net equity' is calculated as the difference between what the debtor owes the customer and what the customer owes the debtor on the date the SIPA proceeding is filed."); Madoff Securities SIPC Customer Claim Form (defining the customer's claim in terms of the cash and/or securities Madoff Securities owed to the customer and the cash and/or securities the customer owed to Madoff Securities as of December 11, 2008).

This statutory definition is clear and easily applied to the Madoff Securities liquidation. The typical Madoff customer received written trade confirmations, as well as detailed monthly account statements, reflecting the

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[2] The "indebtedness" of the customer to the debtor refers to cash or securities owed to the debtor, which is most often in the context of a customer having borrowed from the debtor on margin. *See, e.g.*, H.R. Rep. No. 95-746, at 21 (1977) (describing customers owing cash or securities to the stockbroker as "margin customers"); *Rich v. NYSE*, 522 F.2d 153, 156 (2d Cir. 1975) (noting that, under the 1970 statutory regime, when there were shortages in available securities to satisfy "net equity" claims, customers received cash for their securities "less, in the case of holders of margin accounts, amounts owed" to the broker); *In re First Street Sec. Corp.*, 34 B.R. 492, 497 (Bankr. S.D. Fla. 1983) (offsetting against claim amount of indebtedness customer owed to the debtor where unauthorized stock purchase was funded in part by borrowing on margin).

customer's "securities positions" in real and publicly verifiable securities (e.g., IBM, AT&T).[3] SIPA explicitly provides that the customer's "net equity" is the amount "owed by the debtor to [the] customer," determined by calculating what the value of the customer's "securities positions" would have been had those positions been liquidated on the filing date.

The fact that the securities were never purchased does not affect this analysis. SIPA necessarily assumes – and as discussed in Section 2 below, the legislative history of SIPA expressly contemplates – that the "securities positions" reflected in the customer's statements may reflect securities that were never actually purchased. That the securities were not actually purchased does not in any way alter the fact that the broker "owes" the customer the value of those "securities positions." Thus, because under SIPA the only permitted offset to the value of the customer's "securities positions" is any indebtedness of the customer to the debtor, absent any margin loans or other such indebtedness, a Madoff customer's "net equity" claim is the value of the "real" securities identified in the customer's confirmations and account statement as of December 11, 2008, the date of the Madoff filing.

By contrast, the Trustee's view on this critical, threshold issue for every claimant in the Madoff SIPA proceeding has no textual support in the statute.[4] To interpret "net equity" as the Trustee does would not only result in claim valuations that are completely inconsistent with SIPA's express language, it would also render the SIPA "net equity" provision entirely superfluous, in contravention of firmly established canons of statutory construction.[5] SIPA expressly includes a clear definition of "net equity" and the Trustee is not free to ignore it. The SEC can and should exercise its authority over SIPC to preclude the Trustee from attempting to engraft upon the SIPA regime a wholesale replacement of its statutory definition with an unprecedented and unsupportable "cash in, cash out" valuation methodology.

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[3] Indeed, each monthly account statement Madoff customers received included a specific section entitled "Security Positions," which set forth (1) the list of securities held in the account at the end of the calendar month, (2) the number of shares of each such security, (3) the price per share of each security position, and (4) the total market value of all the security positions (for both stocks and options).

[4] The Trustee's position also runs counter to what any rational investor would believe she is "owed" by her broker-dealer. Certainly no such investor could conceive that once she has withdrawn over the life of her investment account more money than she had deposited, her broker-dealer no longer "owed" her anything.

[5] *See State St. Bank & Trust Co. v. Salovaara*, 326 F.3d 130, 139 (2d Cir. 2003) ("It is well-settled that courts should avoid statutory interpretations that render provisions superfluous: 'It is our duty to give effect, if possible, to every clause and word of a statute.'") (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001)).

2. The Trustee's View of "Net Equity" Runs Counter to SIPA's Legislative History and Purpose

The Trustee's "cash in, cash out" definition of net equity is also inconsistent with the legislative history of the statute. The paramount concern of the statute, as made clear by its legislative history, is to meet the legitimate expectations of broker-dealer customers. Such legitimate expectations almost always begin and end with what customers see in their written confirmations and monthly account statements, as well as in publicly available information about the securities reflected in those records. In the case of the Madoff Securities customers, these information sources gave them every legitimate expectation that their accounts, in fact, held the securities reflected therein at the prices and values set forth. By disregarding the plain language of the statute, the Trustee has wholly ignored those legitimate expectations, and, in so doing, has acted in direct contravention of the purpose of the statute.

SIPA was enacted in 1970 to protect investors and maintain their confidence in the financial markets. H.R. Rep. No. 91-1613, at 3-4 (1970) ("This legislation [SIPA] . . . is designed to effect two aims. It will establish immediately a substantial reserve fund which will provide protection to customers of broker-dealers . . . . This will reinforce the confidence that investors have in the U.S securities markets. In addition, [it] will provide for a strengthening of the financial responsibilities of broker-dealers.").[6] Under its original statutory scheme, SIPA aimed to do this by satisfying customers' "net equity" securities claims with actual securities, but only if the debtor had securities of the appropriate class and kind available in sufficient quantities to satisfy customers' claims.[7] Otherwise customers would receive the cash equivalents of the filing date value of the securities purportedly held.[8]

In 1978, Congress proposed amendments to SIPA to "satisfy more adequately customer expectations."[9] As Congressman Robert Eckhardt

[6] *See also In re New Times*, 371 F.3d at 87 ("[T]he [SIPA] drafters' emphasis was on promoting investor confidence in the securities markets and protecting broker-dealer customers."); *Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 794 (6th Cir. 1995) ("'Congress enacted [SIPA] to . . . restore investor confidence in the capital markets[] and upgrade the financial responsibility requirements for registered brokers and dealers.'") (citing *Barbour*, 421 U.S. at 415)); *Sec. Investor Prot. Corp. v. Morgan, Kennedy & Co.*, 533 F.2d 1314, 1318 n.5 (2d Cir. 1976) (same).

[7] SIPA § 6(c)(2)(B)-(D), Pub. L. No. 91-598, 84 Stat. 1636, 1648-50 (1970); H.R. Rep. No. 95-746, at 39 (statement of SIPC Chairman Hugh F. Owens). Under its original enactment, SIPA defined "net equity," in relevant part, as "the sum which would have been owing by the debtor to the customer had the debtor liquidated, by sale or purchase on the filing date, all other securities and contractual commitments of the customer," minus any indebtedness of the customer to the debtor. SIPA § 6(c)(2)(A)(iv), Pub. L. No. 91-598, 84 Stat. at 1648.

[8] SIPA § 6(c)(2)(B)-(D), Pub. L. No. 91-598, 84 Stat. at 1648-50; H.R. Rep. No. 95-746, at 41 (statement of SIPC Chairman Hugh F. Owens).

[9] D 922 Cong. Rec. H. 36326 (daily ed. Nov. 1, 1977) (statement of Representative Robert C. Eckhardt).

commented at the time, "[o]ne of the greatest shortcomings of the procedure under the 1970 Act, to be remedied by [the 1978 amendments], is the failure to meet legitimate customer expectations of receiving what was in their account at the time of their broker's insolvency." *Id.*[10] Those expectations were that the customers owned actual securities, as reflected on their statements, which would be returned to them, whenever possible, "in the form they existed on the filing date." H.R. Rep. No. 95-746, at 21. Thus, SIPA was amended to provide 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 . . . ." 15 U.S.C. § 78fff-2(d); SIPA § 8(d), Pub. L. No. 95-283, 92 Stat. 249, 263 (1978).

Perhaps most importantly to the Madoff proceeding, the SIPA legislative history confirms Congress's intention that broker-dealer customers have valid net equity claims even when the securities reflected on their confirmations and account statements were never purchased. Both the Senate and House reports on the 1978 amendments clearly reflect that a customer's net equity claim is not at all dependent on whether the securities were actually purchased by the broker-dealer:

> "Under present law, because securities belonging to customers may have been lost, improperly hypothecated, misappropriated, *never purchased* or even stolen, it is not always possible to provide to customers that which they expect to receive, that is, securities which they maintained in their brokerage account. . . . By seeking to make customer accounts whole and returning them to customers in the form they existed on the filing date, the amendments . . . would satisfy the customers' legitimate expectations . . . ."

S. Rep. No. 95-763, at 2 (1978) (emphasis added).

> "A customer generally expects to receive what he believes is in his account at the time the stockbroker ceases business. But because securities may have been lost, improperly hypothecated, misappropriated, *never purchased*, or even stolen, this is not always possible. Accordingly, [when this is not possible,

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[10] *See also, e.g., Hearing on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 94th Cong. 63 (1975) ("The basic framework of the 1970 Act in regard to satisfaction of customers' claims should be modified to better meet the legitimate expectations of customers.") (report to the SIPC Board of Directors by the Special Task Force to consider possible amendments to SIPA); *Hearing on H.R. 8331 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 95th Cong. 81 (1977) ("The proposed [1978] amendments carry out the Task Force recommendations and are designed to make the Act more responsive to the reasonable expectations of investors.") (statement of SIPC Chairman Hugh F. Owens); *Hearing on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 94th Cong. 161-62 ("[T]he principal purpose of these amendments is to meet more nearly the reasonable expectations of brokerage firm customers.") (statement of SEC Commissioner Philip A. Loomis, Jr.).

> customers] will receive cash based on the market value as of the filing date."

H.R. Rep. No. 95-746, at 21 (emphasis added).

Neither the 1970 statute, nor the 1978 amendments, nor the legislative history of SIPA provides any support for the Trustee's "cash in, cash out" net equity theory.[11] Rather, it is the straightforward and statutorily based "securities positions" definition of net equity, and not the Trustee's "cash in, cash out" theory, that is in full accord with SIPA's purpose. That "securities positions" definition gives broker-dealer customers the critical comfort that SIPA was intended to provide: knowledge that the securities positions in their accounts – the values of which are publicly verifiable – are protected by SIPC up to $500,000 per account. Importantly, this is so regardless of whether the securities had ever, in fact, been purchased, and regardless of whether, over the life of the account, the customer had taken out more money than she had deposited.

Until this case, an investor did not have to worry – and certainly has never been warned – that SIPA might not mean what it says, that it might not cover what it was intended to cover, and that it might only cover accounts in which the investor's lifetime deposits exceeded her lifetime withdrawals (and then only up to the net of those amounts). Such a drastic departure from a clear statutory provision, that is also so contrary to the underlying purpose of the statute, must not be allowed in any case, including this one.

3. SIPC Precedent and the Leading Second Circuit Authority Are Contrary to The Trustee's Position

SIPC faced very similar circumstances in the New Times Securities Services, Inc. ("New Times") liquidation. There, the New Times Trustee's position on "net equity" was in full accord with SIPA, and thus directly contrary to the Madoff Securities Trustee's position in this case. Specifically, with respect to any claims that were based on confirmations and account statements reflecting securities positions in "real" securities that could have been purchased (i.e., securities that actually existed on the public market and whose valuations were objectively and publicly verifiable by the customers), the New Times Trustee

[11] As then-SIPC Chairman Hugh F. Owens further explained by way of a hypothetical: "[C]ustomers generally expect to receive what is in their accounts when the member stops doing business. If John Q. Investor has 100 fully-paid shares of IBM and a credit balance of $200 in his account, he expects to receive from the trustee a stock certificate for 100 shares of IBM and a check for $200. But in many instances that has not always been possible because securities have been lost, improperly hypothecated, misappropriated, never purchased, or even stolen." H.R. Rep. No. 95-746, at 39 (explaining that where John Q. Investor only receives the filing date cash value of his IBM securities, he will fail to realize any rise in the IBM stock price since that time). Implicit in Owens' hypothetical is the premise that "John Q. Investor" has a "valid claim" for the number of shares of IBM stock identified in his account statement as of the filing date, even when the brokerage had "never purchased" the stock for him. Nothing in Owens' hypothetical suggests that John Q. Investor's claim should be reduced to the extent he has withdrawn funds from the account over time.

allowed all such net equity claims to the full extent of the filing date valuations of those securities, even though none of the securities identified in those records had ever, in fact, been purchased by the broker-dealer. The Madoff investors are in precisely the same position as the "real" securities claimants in New Times and should be treated no differently.

As with Madoff Securities and Bernard Madoff, New Times Securities and its principal, William Goren, defrauded scores of investors by providing them with confirmations and account statements reflecting purported securities investments made on their behalf when, in fact, no such investments had been made and their money had, instead, been misappropriated for other purposes. Two of the investment opportunities Goren purported to offer were: (1) money-market funds that were entirely fictitious (the "Fictitious New Age Funds"); and (2) mutual funds that were entirely real, such as those offered by The Vanguard Group and Putnam Investments (the "Real Securities"). *See In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 71-72 (2d Cir. 2004) ("*New Times I*"). Goren's was "a classic Ponzi scheme," *Id.* at 72 n.2, wherein new investors' money was used to pay earlier investors.

Approximately 900 customers filed claims in the New Times liquidation: 726 for whom the "Real Securities" were purportedly purchased; 174 for whom the "Fictitious New Age Funds" were purportedly purchased. Consistent with SIPA and its legislative history, the New Times Trustee appropriately applied SIPA's net equity definition to the "Real Securities" customers' claims – meaning he paid them according to the full value of those securities positions as of the date of the liquidation filing. When challenged by "Fictitious New Age Funds" customers who had objected that they had not received the same treatment, SIPC and the New Times Trustee (with the apparent concurrence of the SEC) vigorously defended their approach with respect to the "Real Securities" customers' claims:

- "[O]ur view [is] that when possible, SIPA should be interpreted consistently with a customer's legitimate expectations based on confirmations and account statements." (Br. of the SEC, Amicus Curiae, In Partial Support of the Position of Appellants and In Partial Support of the Position of Appellees ("SEC Amicus Curiae Brief") at 13, *New Times I* (No. 02-6166));

- "In every case [of a 'Real Security' customer], the Trustee has been able to identify the actual mutual fund in question by cross-checking the information supplied by Goren on the customer statements, including share price information, with publicly available information and then been able to purchase that security." (Joint Mem. of Law in Support of Trustee's Motion for an Order Upholding the Trustee's Determinations With Respect to Claims Filed for Investments in Non-Existent Money Market Funds and Expunging Objections to Those Determinations ("Joint Mem. in Support of Order Upholding Determinations") at 26, *SEC v. Goren*, 206 F. Supp. 2d 344 (E.D.N.Y. 2002) (No. 00-CV-970));