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Advocating for Asset Forfeiture in the Post-Madoff Era: Why the Government, Not a Bankruptcy Trustee, Should Be Responsible for Recovering and Redistributing Assets from Feeder Funds and Net Winners

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— Note —

ADVOCATING FOR ASSET FORFEITURE IN THE POST-MADOFF ERA: WHY THE GOVERNMENT, NOT A BANKRUPTCY TRUSTEE, SHOULD BE RESPONSIBLE FOR RECOVERING AND REDISTRIBUTING ASSETS FROM FEEDER FUNDS AND NET WINNERS

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INTRODUCTION

On December 11, 2008, Natalie Erger and her seventy-eight year-old husband’s financial lives came to a screeching halt. In a matter of seconds they had gone from comfortably retired to penniless. They still had three car payments, a mortgage, and other living expenses, but they suddenly found themselves with no money except Social

Security payments and the balance in their checking account.¹ They couldn't make their mortgage payments or find someone to purchase their home, and they found it nearly impossible to work at their age.² Natalie and her husband were "trapped in a life style that [they] never would have chosen if [they] knew [they] didn't have the money to support it."³ Despite their personal hardship, they worried even more about their children and grandchildren. No longer could they afford a tutor for their grandson with a learning disability or fly their eleven grandchildren out to see them for the holidays. Instead, they had become destitute, requiring assistance from their children and siblings just to survive.⁴ The Ergers' story, like those of so many others, was the catastrophic result of investing their life savings in Bernie Madoff's Ponzi scheme. But the con man's fraud was not limited to novice investors such as the Ergers. He stole from longtime friends,⁵ charitable organizations,⁶ and even celebrities such as Steven Spielberg.⁷ A few investors, so distraught after learning of the fraud, even took their own lives.⁸

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1. U.S. Attorney's Letter and Attached Victim Impact Statements at 19, *United States v. Madoff*, 09 Cr. 213 (S.D.N.Y. 2009), *available at* http://i.usatoday.net/money/_pdfs/09-0616-madoff-victims.pdf.
 2. *Id.* (letter from Natalie Erger to Judge Chin) ("I can't roll back the clock and become 40 again. I'm told I don't have the technological skills that are required for even entry level jobs. . . . My husband . . . [who] served his country in the Korean War . . . went to work doing telephone customer sales for commission only. He worked from 7:30 a.m. until 8:30 p.m. six days a week. He was terminated after three months because he did not make the quota of sales they projected. He is now trying to do hosting at a local bagel store.").
 3. The Ergers stated that they never would have bought an expensive home in a residential country club community if they had known about the Ponzi scheme that decimated their financial lives. *Id.*
 4. *Id.*
 5. See Christine Hurt, *Evil Has a New Name (and a New Narrative): Bernard Madoff*, 2009 MICH. ST. L. REV. 947, 958 ("Madoff rendered penniless . . . his best friend Carl Shapiro.").
 6. See ANDREW KIRTZMAN, *BETRAYAL: THE LIFE AND LIES OF BERNIE MADOFF* 247 (2009) (stating that the \$15.2 million invested with Madoff by the Elie Wiesel Foundation for Humanity had been completely wiped out).
 7. Hurt, *supra* note 5, at 960.
 8. Rene-Thierry de la Villehuchet, a wealthy hedge fund advisor, locked himself in his office above Midtown Manhattan, took a number of sleeping pills, and slashed his left arm open with a box cutter after hearing about Madoff's arrest. Villehuchet had placed around \$1.4 billion of his own and his clients' funds with Madoff. See Alex Berenson & Matthew Saltmarsh, *The Suicide of a Trader Contributes to Mysteries*, N.Y. TIMES, Jan. 2, 2009, at B1.

These horrific tragedies led to the appointment of Irving Picard as the Securities Investor Protection Act (“SIPA”) Trustee on December 15, 2008 for Bernie Madoff and Bernard L. Madoff Investment Securities (“BLMIS”).⁹ As trustee, Picard’s duty is to investigate the financial affairs of Madoff and BLMIS, recover and reduce to money as much property as possible, and deliver that money in a way that is most “practicable in satisfaction of customer claims.”¹⁰ This power has resulted in over 1,000 lawsuits against individuals and companies that he claims owe money to families such as the Ergers. The lawsuits require Picard to seek recovery of funds predominantly from two groups of individuals and entities who actually benefited from the fraud: “feeder funds,” which were entities that helped recruit investors to join the scheme, and “net winners,” investors who joined the scheme early and withdrew far more fictitious profits than they invested in principal. From the feeder funds, Picard seeks to recover fees and other forms of compensation they received, as well as punitive and compensatory damages, under theories of stolen customer property and unjust enrichment.¹¹ From net winners, Picard seeks to recover fictitious profits and in some cases invested principal, citing theories of fraud and willful blindness.¹² Unfortunately, many of these lawsuits are doomed to fail or to recover only a fraction of what is sought. In fact, courts have already ruled against Picard in some of them.¹³ Considering these inevitable outcomes, the need for a new approach when dealing with asset distribution following discovery of a Ponzi scheme has become apparent.

This Note explores criminal and civil asset forfeiture by the United States government as a viable alternative to bankruptcy proceedings when dealing with Ponzi schemes and the fair distribution of recovered assets to victims. It focuses on current and recently settled litigation dealing with Bernie Madoff’s Ponzi scheme and the liquidation of assets, but also suggests how assets should be seized and distributed as Ponzi schemes are uncovered in the future. Finding

9. 15 U.S.C. §§ 78aaa–78lll (2006).

10. § 78fff-1(b)(1) (2006).

11. See Amended Complaint at 17, *Picard v. HSBC Bank PLC*, 450 B.R. 406 (S.D.N.Y. 2011) (Adv. Pro. No. 09-1364 (BRL)) [hereinafter *HSBC Bank Amended Complaint*] (“[T]he Trustee seeks the return of Customer Property belonging to the BLMIS estate, including redemptions, fees, compensation, and assets, as well as compensatory and punitive damages caused by the Defendants’ misconduct, and the disgorgement of all amounts by which the Defendants were unjustly enriched at the expense of BLMIS’s customers.”).

12. Amended Complaint at 6, *Picard v. Katz*, 462 B.R. 447 (S.D.N.Y. 2011) (Adv. Pro. No. 10-5287 (BRL)).

13. See discussion of feeder fund and net winners cases *infra* Part II.

a way to collect and distribute Ponzi funds efficiently and fairly will be important for years to come as “[t]he drying up of money caused by the recent financial crisis has unearthed numerous Ponzi schemes nationwide.”¹⁴

Part I describes how a Ponzi scheme such as Bernie Madoff’s works and the types of entities from which a SIPA Trustee attempts to recover funds. Part II identifies current bankruptcy trustee tactics used to recover assets from third parties involved in Ponzi schemes. It also shows why Picard is unlikely to recover the funds he seeks from these third parties. Courts have begun to find either that he does not have the requisite standing to recover the funds he seeks or that he is severely limited in how far back in time he may reach to recoup fictitious profits from investors. This Part examines recent high-profile cases and opinions, with a focus on the now-settled lawsuit against the owners of the New York Mets.

Part III discusses asset forfeiture as an alternative to bankruptcy proceedings in light of forfeiture’s history and purpose. Part III also explains how asset forfeiture is currently used in Ponzi-scheme cases to recover the assets of individuals responsible for the fraud. It explores the current criticisms of the government entering into an area that has historically been the exclusive realm of bankruptcy trustees. It also refutes those criticisms by explaining that the government has the same goals as the SIPA trustee—fair distribution of monies to victims. Finally, Part IV discusses why asset forfeiture is a more cost-effective and efficient option for recovering and distributing funds than the bankruptcy proceedings currently in place. It proposes that criminal and civil asset forfeiture is the best solution for dealing with the assets of the individual responsible for the Ponzi scheme, as well as the assets of third parties who benefitted from the fraud in some way. Asset forfeiture would allow for the quick recovery and distribution of funds to Ponzi scheme victims on a pro rata basis without thousands of costly lawsuits.

I. PONZI PROBLEM: COLLECTING AND DISTRIBUTING MONEY THAT DOES NOT EXIST

A. *How a Ponzi Scheme Works*

Bernie Madoff’s scheme was simple. His company, Bernard L. Madoff Investment Securities, was registered with the SEC as a securities broker-dealer and run by its “founder, chairman, and chief executive officer, [Bernie] Madoff, with several family members and a number of additional employees.”¹⁵ To perpetuate the fraud, Madoff

14. Joshua Marcus & Jake Greenberg, Recent Development, *Ponzi Schemes: Washed Ashore by Recession’s Low Tide, Reveal Controversial Issues*, AM. BANKR. INST. J., Oct. 2010, at 48.

15. *Picard v. Merkin* (*In re* Bernard L. Madoff Inv. Sec. LLC), 440 B.R. 243, 250 (Bankr. S.D.N.Y. 2010) (explaining that the firm consisted of

would keep accounts for all of his investors and show them statements containing fictitious profits made from securities trades.¹⁶ But in reality, Madoff was not making any trades at all.¹⁷ He simply recruited individuals to invest in his firm, and then used their money to pay other investors when “requests for distribution of ‘profits’ were made.”¹⁸ Eventually, the money began to dry up as people began taking much more out than was coming in via new investments. In the end, “the market that Madoff had dominated for decades finally destroyed him.”¹⁹ The burst of the housing bubble in 2008 and the resultant global financial crisis spelled the end for BLMIS. The jig, as they say, was up.²⁰

B. The Unenviable Task of Recovering Fictitious Profits

Once a Ponzi scheme such as Madoff’s is discovered, the Securities Investor Protection Corporation (SIPC) steps in under SIPA.²¹ Although created by statute, the organization is not an “agency or establishment of the United States Government.”²² Rather, it is a nonprofit membership corporation, funded by its registered broker-dealer members.²³ The mission of the SIPC is to help return assets to customers of brokerage firms that close due to various financial difficulties.²⁴ Under SIPA, the SIPC may file for a protective decree with a U.S. district court if it determines that any member of the SIPC “has failed or is in danger of failing to meet its obligations to

three units—an investment advisory business, a market making business, and a proprietary trading business—and that the fraud was conducted through the investment advisory unit).

16. *Id.*
17. *Id.* (“[T]here is no record of BLMIS having cleared any purchase or sale of securities in the Depository Trust & Clearing Corporation.”).
18. *Id.* at 251.
19. HARRY MARKOPOLOS, *NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER* 200 (2010).
20. *See id.* at 201 (“[T]oo many of Madoff’s investors were desperate for cash to protect their investments and meet their growing client redemptions, and attempted to withdraw their money—apparently these requests totaled more than \$7 billion.”).
21. 15 U.S.C. §§ 78aaa-78lll (2006).
22. § 78ccc(a)(1)(A).
23. § 78ccc(a)(1), (2)(A).
24. *See The SIPC Mission*, SEC. INVESTOR PROT. CORP., www.sipc.org/Who/SIPCMission.aspx (last visited Nov. 17, 2012) (“When a brokerage firm is closed due to bankruptcy or other financial difficulties and customer assets are missing, SIPC steps in as quickly as possible and, within certain limits, works to return customers’ cash, stock and other securities, and other customer property.”).

customers.”²⁵ As a registered broker-dealer, BLMIS was a member of the SIPC, and after the fraud was revealed it became obvious that the company would not be able to meet its obligations to customers. Thus, the SIPC filed an application for a protective decree, which was granted by the district court. The protective order gave the court complete control over Madoff’s property, and also required the appointment of a trustee for BLMIS to redistribute assets to investors.²⁶

Trustees under SIPA have the same duties as a trustee under Title 11 of the bankruptcy code, and the additional duty to “deliver securities to or on behalf of customers to the maximum extent practicable in satisfaction of customer claims.”²⁷ With a Ponzi scheme as massive as Madoff’s, these duties become much more difficult than simply liquidating company assets and distributing them according to customer claims. The trustee, Picard, along with a massive platoon of attorneys, special experts, consultants, and international counsel, is “engaged in a broad range of activities . . . including evaluating claims, conducting forensic analysis of years of documents, working through complex negotiations, filing and responding to motions, assembling detailed complaints and litigating them.”²⁸ The result of these investigations, going on since December 2008, has been over 1,000 lawsuits in which Picard seeks to recover over \$100 billion.²⁹ The lawsuits grabbing many recent headlines involve two groups that were a part of the Madoff scandal, feeder funds and net winners.³⁰ Picard is seeking to recover funds he believes these groups do not deserve, as they either failed to perform due diligence when recruiting investors for BLMIS or they received fictitious profits that should be returned to victims who lost everything.

25. 15 U.S.C. § 78eee(a)(3)(A).

26. See § 78eee(a)–(b)(3) (stating that the SIPC may “file an application for a protective decree with any court competent of jurisdiction,” and if the court issues a protective decree, it shall also appoint a trustee for the liquidation of the business for the debtor).

27. § 78fff-1(b); see also 11 U.S.C. § 704 (2006) (listing the duties of a trustee involving bankruptcy proceedings).

28. Irving H. Picard, *A Message from SIPA Trustee Irving H. Picard*, THE MADOFF RECOVERY INITIATIVE, www.madoff.com/trustee-message-02.html (last visited Nov. 17, 2012).

29. Michael Rothfeld, *The Man with the Thankless Job*, WALL ST. J., Mar. 5-6, 2011, at B1.

30. See Diana B. Henriques, *Despite Doubts, JPMorgan Kept Ties to Madoff*, N.Y. TIMES, Feb. 4, 2011, at A1. (discussing lawsuits filed by Irving Picard against JPMorgan and other feeder fund banks that he claimed received millions of dollars in fees from BLMIS without performing proper due diligence); Richard Sandomir, *Actions of Madoff Victims’ Trustee Will Be Reviewed*, N.Y. TIMES, July 29, 2011, at B15 (acknowledging that Congress will be investigating the actions of Picard in regard to his lawsuits against net winners of Madoff’s scheme).

1. The Feeder Funds

Feeder funds in a Ponzi scheme such as Madoff's are banks and individuals "that acted as middlemen between Madoff and the investors [and] were, in effect, an ad hoc sales force."³¹ They would seek investors and then outsource management of the invested funds to Madoff.³² In return, Madoff would pay these banks handsomely, often hundreds of millions of dollars, as a type of finder's fee. In addition to being a sales force, although they claim to not have known it, they provided Madoff with a "legitimate structure" between his fraud and investors that gave him a "protective buffer to help . . . fend off skeptical inquiry."³³

The easiest way to understand how feeder funds work is to put oneself in the shoes of an investor. Assume you are an individual who wants to invest your life savings for retirement. You approach a bank or investment advisor about investing your money in various types of securities, and in return you pay them a fee. Unfortunately, that advisor is "feeding" your funds to Madoff without doing his or her proper due diligence in investigating him, and in a sense double-dipping between your fees and fees he or she receives from Madoff's company. Since your advisor did not recognize the red flags indicating that Madoff was a fraud (or chose to ignore them), all of your money is lost when the scheme is uncovered, even though you have no idea who Bernie Madoff or BLMIS is.³⁴ Situations such as these are the reason Picard has chosen to file lawsuits against banks such as HSBC and JPMorgan Chase.³⁵

2. The "Winners" of the Ponzi Scheme

Another group of individuals and companies from whom Picard is attempting to recover are the net winners. Not everyone who invested with Bernie Madoff lost his or her life savings. In fact, some investors

31. 6 ALAN R. BROMBERG & LEWIS D. LOWENFELS, BROMBERG AND LOWENFELS ON SECURITIES FRAUD § 19:17 (2d ed. 2012).

32. *Id.*

33. *Id.*

34. For an example of this involving Madoff and his feeder funds, see *People ex rel. Cuomo v. Merkin*, No. 450879/09, 2010 WL 936208, at *1 (N.Y. App. Div. Feb. 8, 2010) ("[The New York Attorney General alleges that Merkin] blindly fed the investors' funds into a Ponzi scheme orchestrated by Bernard L. Madoff . . . while claiming that [he] was actively managing those funds."); *see also* Amended Complaint, *Picard v. HSBC*, *supra* note 11, at 52 (claiming that HSBC observed and internally reported many signs that indicated a massive fraud, specifically in the form of "supernaturally consistent returns," but did not report out to anyone).

35. *See* discussion of feeder fund cases *infra* Part II.A.

actually ended up with significantly more money than they put in.³⁶ Picard filed hundreds of lawsuits against these “winners” so as to redistribute the money invested with BLMIS evenly.³⁷ The winners tend to be individuals who invested early with Madoff and his Ponzi scheme, and in doing so took out enormous “profits” over the years. Unfortunately, those profits turned out to be nothing more than money coming in from subsequent investors in the fraud. Picard hopes to recover these fictitious profits through what have been dubbed “clawback” suits.³⁸ Clawbacks are essentially a means of “recovering benefits that have been conferred under a claim of right, but that are nonetheless recoverable because unfairness would otherwise result.”³⁹ Picard hopes to use this theory to act as a type of legal Robin Hood, taking from the rich and giving to the poor.

II. DIFFICULTIES ARISING FROM THE TRUSTEE’S RECOVERY TACTICS

Following a Ponzi scheme, the trustee has a duty to oversee the liquidation of the offending company, distribute assets of the fraud, and create “the largest Customer Fund . . . possible” so that every creditor can receive some compensation for his or her loss.⁴⁰ This includes holding sophisticated investors such as feeder funds

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36. Picard alleges that by December of 2008, Saul Katz and Fred Wilpon, through their company Sterling Investors, family members, trusts, and entities, had withdrawn approximately \$300 million in fictitious profits, along with over \$700 million in principal from BLMIS in the six years before the Ponzi scheme was discovered. *See* Amended Complaint, Picard v. Katz, *supra* note 12, at 138–39. This Note will focus on Picard’s lawsuit against the owners of the New York Mets for a number of reasons, although hundreds of very similar suits against other parties have been filed. Their case has received a lot of publicity due to the celebrity of the parties and the significant amount of money involved, making it influential in the other “clawback” cases.
37. Despite the staggering number of lawsuits, it is important to note that Picard is not going after absolutely everyone who made a profit from the scheme. *See* Dick Carozza, *Balancing Act: An Interview with Irving H. Picard, Madoff Trustee*, FRAUD MAGAZINE, July-Aug. 2010, at 36, 38 (stating that he realizes many of the individuals who received fictitious profits are elderly or have serious financial or medical hardships, so he will only seek to recover funds from parties who were significant net winners).
38. *See, e.g.*, Jane J. Kim, *As ‘Clawback’ Suits Loom, Some Investors Seek Cover*, WALL ST. J., Mar. 12, 2009, at C3 (describing how many investors are preparing for “clawback” suits by Picard).
39. Miriam A. Cherry & Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 371–72 (2009).
40. Picard, *supra* note 28.

accountable for turning a blind eye to the giant red flags and warning signs at BLMIS.⁴¹ Additionally, the SIPA Trustee must ask investors who withdrew more fictitious profits than they deposited to return the excess money and have it redistributed fairly.⁴² Not surprisingly, the net winners are unwilling to do so. The result has been numerous lawsuits opposing the “clawbacks” and even questioning from members of Congress about these actions.⁴³ Some members of Congress believe that “clawing back” funds in this manner from innocent individuals goes against the SEC’s goal of protecting investors.⁴⁴

Nevertheless, Picard has targeted both groups in court. The suits against feeder funds have asked for not only the return of millions of dollars in fees but also punitive damages for failing to perform due diligence in investigating BLMIS. Had the feeder funds investigated properly, the result likely would have been a far earlier end to one of the largest frauds in history. Picard has continued his lawsuits against net winners as well, although not against individuals whom he has deemed to have “extenuating financial circumstances” that would make returning the funds a substantial hardship.⁴⁵ Although a number of these cases are still in litigation, some early opinions strongly suggest Picard will not receive the type of recovery he hopes for.

A. *The Feeder Fund Cases*

As a result of the feeder fund actions, on December 5, 2010, Picard filed an amended complaint against HSBC and thirty-six other defendants, labeling them “feeder funds and various service providers to the funds,” seeking \$2 billion under bankruptcy law claims and another \$6.6 billion under common law claims.⁴⁶ He filed similar claims against other banks, such as JPMorgan Chase & Co., as well.⁴⁷ Both complaints were originally filed in bankruptcy court but were removed to the United States District Court for the Southern District of New York as they contained two issues that required “substantial

41. *Id.*

42. *Id.*

43. Sandomir, *supra* note 30, at B15.

44. *Id.*

45. Picard, *supra* note 28; *see also* Zachery Kouwe, *Madoff’s Trustee Starts Victims’ Hardship Plan*, N.Y. TIMES, May 9, 2009, at B5 (describing how Picard evaluates each investor’s situation to determine whether he will ask them to return funds or not).

46. Picard v. HSBC Bank PLC (*HSBC I*), 450 B.R. 406, 408 (S.D.N.Y. 2011).

47. *See* Amended Complaint and Demand for Jury Trial at 49, Picard v. JPMorgan Chase & Co., 460 B.R. 84 (S.D.N.Y. 2011) (No. 08-1789 (BRL)).

and material interpretation of non-bankruptcy federal law.”⁴⁸ Those issues were (1) “whether the Trustee [had] standing to bring [such] common law claims” and (2) “whether the Trustee’s Action is a ‘covered class action’ that is preempted by [the Securities Litigation Uniform Standards Act].”⁴⁹

For the common law claims, Judge Jed S. Rakoff ruled that Picard, in his capacity as SIPA Trustee, lacked standing in federal court to sue the feeder funds.⁵⁰ The reason was that, in federal court, “a party must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties.”⁵¹ Picard argued that he has standing to bring common law claims against banks such as HSBC on behalf of the creditors or customers who were swindled by Madoff.⁵² He asserted that “he has standing to bring [these claims] as bailee of the property of Madoff Securities’ customers.”⁵³ He also contended that the language and structure of SIPA gives him this power.⁵⁴ Judge Rakoff was quick to poke holes in these arguments. First, he noted that Picard, as trustee, is standing in the shoes of the debtors (Madoff and BLMIS) to redistribute their assets, not in the shoes of Madoff’s creditors, and “it is settled law that the federal Bankruptcy Code (Title 11, United States Code) does not itself confer standing on a bankruptcy trustee to assert claims against third parties on behalf of the estate’s creditors themselves.”⁵⁵ Second, SIPA says that the trustee is “vested with the same powers . . . as a trustee in a case under title 11,”⁵⁶ and therefore it does not “implicitly afford the Trustee authority, beyond that

48. *HSBC I*, 450 B.R. at 410.

49. *Id.* at 410, 413.

50. *See* Picard v. HSBC Bank PLC (*HSBC II*), 454 B.R. 25, 33 (S.D.N.Y. 2011) (“[T]he Court rejects *in its entirety* the claim by the Trustee that he has standing to bring his common law claims as bailee of customer property.” (emphasis added)), *opinion amended by* Picard v. Merkin (*In re Bernard L. Madoff Inv. Sec. LLC*), No. 11 Civ. 763(JSR), 11 Civ. 836(JSR), 2011 WL 3477177, at *1 (S.D.N.Y. Aug. 8, 2011) (amended to include dismissal of the Trustee’s claims against UniCredit Bank Austria AG). Judge Rakoff plays a major role in many cases dealing with the Madoff liquidation.

51. *Id.* at 29 (quoting *Wight v. BankAmerica Corp.*, 219 F.3d 79, 86 (2d Cir. 2000) (internal quotation marks omitted)).

52. *Id.* at 28.

53. *Id.* at 29.

54. *Id.* at 30.

55. *Id.* at 29 (citing *Caplin v. Marine Midland Grace Trust Co. of N.Y.*, 406 U.S. 416, 434 (1972)).

56. *Id.* at 30 (citing 15 U.S.C. § 78fff-1(a)).

afforded to a bankruptcy trustee.”⁵⁷ Judge Rakoff even cited the common law doctrine of *in pari delicto*, which “precludes a wrongdoer like Madoff Securities from recovering from another wrongdoer.”⁵⁸ This means that the trustee, who is standing in the shoes of the wrongdoer, BLMIS, cannot recover from HSBC, the feeder fund from which Picard seeks billions, because they are both wrongdoers.

To put it bluntly, Judge Rakoff “simply applied what he calls ‘ordinary use of the English language’ to conclude that no reading of the relevant laws or cases grants Picard standing to sue the banks for unjust enrichment and aiding and abetting fraud and breach of fiduciary duty.”⁵⁹ A few months later, Judge Rakoff’s colleague and neighbor in the Manhattan federal courthouse, Judge Colleen McMahon, bolstered Rakoff’s opinion in *Picard v. JPMorgan Chase & Co.*⁶⁰ Again, Picard was seeking damages under claims of “aiding and abetting fraud and breach of fiduciary duty, . . . unjust enrichment, [and] conversion,” among other claims.⁶¹ For the same reasons as Rakoff, Judge McMahon agreed that Picard lacked standing to bring these claims.⁶²

Creating even more doubt as to whether Picard will be able to recover the amounts he seeks from feeder funds are recent settlements such as the one between New York Attorney General Eric Schneiderman and money manager J. Ezra Merkin.⁶³ The Attorney General settled his complaint with Merkin, in which he accused the former hedge fund manager of “blindly [feeding] investors’ funds into a Ponzi scheme orchestrated by Bernard L. Madoff . . . while claiming

57. *Id.* at 30.

58. *Id.* at 29.

59. Alison Frankel, *\$90 Bln Answer: Rakoff Says Picard Has No Standing in Bank Suits*, THOMSON REUTERS NEWS & INSIGHT: ON THE CASE BLOG (July 29, 2011), <http://blogs.reuters.com/alison-frankel/2011/07/29/90-bln-answer-rakoff-says-picard-has-no-standing-in-bank-suits/> (quoting *HSBC II*, 454 B.R. at 31).

60. *Picard v. JPMorgan Chase & Co.*, 460 B.R. 84 (S.D.N.Y. 2011).

61. *Id.* at 89. The full amended complaint asserted common law damages claims for “aiding and abetting fraud and breach of fiduciary duty, ‘fraud on the regulator,’ unjust enrichment, conversion, aiding and abetting conversion, knowing participation in a breach of trust, and contribution.” *Id.*

62. *Id.* at 91 (“Three propositions, convincingly established in Judge Rakoff’s recent opinion and equally applicable here, demonstrate that the Trustee lacks standing to pursue his common law claims against Defendants.”).

63. See Diana B. Henriques, *Hedge Fund Manager Agrees to a Madoff Settlement*, N.Y. TIMES, June 25, 2012, at B1 (stating that the deal was approved by a New York judge even though it would undoubtedly be challenged by Picard).

that [he] was actively managing those funds,” for \$405 million.⁶⁴ Picard has sought an injunction related to the settlement, as he “seeks, among other things, the same funds fraudulently received by Merkin.”⁶⁵ Picard believes that if the settlement is carried out, “little or nothing will be left for BLMIS customers,” and he has noted that New York should not be able to “give its citizens . . . a jump start over all the victims of this heinous fraud” by circumventing the SIPA.⁶⁶ If the court denies the injunction, it will leave Picard with even fewer resources from which to repay the victims he represents.

B. The Net Winner Cases

The Bankruptcy Code authorizes Picard, as the SIPA trustee, to recoup funds that were the result of fraudulent transfers or preference actions in a process known in bankruptcy law as avoidance.⁶⁷ Preference actions occur when a bankrupt party transfers his or her assets to certain creditors in preference over other creditors.⁶⁸ When these actions and other fraudulent transfers occur, the trustee has an opportunity to reach “both [the] payments of fictitious profits and withdrawals of principal” from the Ponzi scheme net winners.⁶⁹ Once the funds have been recouped through avoidance procedures, the trustee may redistribute them to individuals who did not profit from the Ponzi scheme, the net losers. Picard is unlikely to recover anywhere near the amount he thought he would from the net winners though, and again Judge Rakoff is the person who has thwarted his plans.

Picard is seeking a total of about \$8 billion to be returned in his clawback claims against all net winners, but under Judge Rakoff’s recent rulings “about \$5 billion of those clawbacks would be

64. People *ex rel.* Cuomo v. Merkin, No. 450879/09, 2010 WL 936208, at *1 (N.Y. App. Div. Feb. 8, 2010).

65. Brief in Support of Trustee’s Application for Enforcement of Automatic Stay and Issuance of Preliminary Injunction at 2, Picard v. Schneiderman (Bankr. S.D.N.Y. Aug. 1, 2012) (Adv. Pro. No. 08-01789 (BRL)).

66. *Id.* at 2–3.

67. See 15 U.S.C. § 78fff-1(a) (2006) (“A trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under title 11.”); see also Picard v. Katz, 462 B.R. 447, 450 (S.D.N.Y. 2011) (“[P]rior payments made by the debtor can be, in effect, rescinded—or, in the language of bankruptcy law, ‘avoided’—and the money returned (‘clawed back’) to the bankrupt’s estate, from where it can be distributed among creditors in accordance with legal and equitable principles of bankruptcy law.”).

68. Katz, 462 B.R. at 450.

69. Tally M. Wiener, *On the Clawbacks in the Madoff Liquidation Proceeding*, 15 FORDHAM J. CORP. & FIN. L. 221, 222–23 (2009).

disallowed.”⁷⁰ The reason is that Rakoff limited how far Picard could reach back to recover funds. In *Picard v. Katz*, Picard was seeking to recover fictitious profits and principal from as far back as six years before the fraud was discovered. But the opinion states that he only has the right to recover funds from “within two years of the filing of the bankruptcy period.”⁷¹ The result is that instead of possibly recovering \$1 billion from individuals such as the Mets’ owners, he has been limited to about \$386 million.

In addition to limiting clawbacks to two years, the *Katz* opinion also narrowed Picard’s ability to recover funds in another way. In lawsuits such as *Katz*, the trustee is attempting to recover funds from net winners using theories of “actual fraud, constructive fraud, preferential treatment, and the like,” but the court dismissed all of the claims except actual fraud.⁷² Under this type of claim, Picard must show an absence of good faith based on willful blindness or actual fraud by the net winners in order to recover their principal investment.⁷³ As a result of this restrictive ruling, Picard and the Mets owners decided to settle for about \$162 million, an amount described as a “major legal victory” for net winners.⁷⁴ A number of legal experts believe that the settlement will “most likely embolden other defendants who are fighting accusations brought by the trustee,” because it is a “surrender [by him] on the explosive assertions that were central to the case.”⁷⁵

If Picard had not settled, and if he could not show actual fraud or willful blindness, his recovery efforts would have been restricted to only monies received by the defendants that they did not provide value for within the last two years.⁷⁶ This means the recovery would only be for fictitious profits going back two years, and not for any of

70. Alison Frankel, *Mets Ruling Could Upend Madoff Bankruptcy*, THOMSON REUTERS NEWS & INSIGHT: ON THE CASE BLOG (Sept. 28, 2011), <http://blogs.reuters.com/alison-frankel/2011/09/28/mets-ruling-could-upend-madoff-bankruptcy>.

71. *Katz*, 462 B.R. at 453.

72. *Id.* at 450.

73. *Id.* at 455–56 (“In short, the Court concludes that, as to the claim of actual fraud (Count 1), the Trustee can recover defendants’ net profits over the two years prior to bankruptcy simply by showing that the defendants failed to provide value for those transfers, but the Trustee can recover the defendants’ return of principal during that same period only by showing an absence of good faith on defendants’ part based on their willful blindness.”).

74. Richard Sandomir & Ken Belson, *Mets’ Owners Agree to Deal in Madoff Suit*, N.Y. TIMES, March 20, 2012, at A1.

75. *Id.*

76. *Katz*, 462 B.R. at 455–56.

the principal invested by the net winners. The net winners' fictitious profits, not their original investments with BLMIS, are the only funds that they did not provide value for. This would have meant that recovery would have been reduced to a paltry \$83 million, as compared to the \$1 billion originally sought.⁷⁷ High-profile outcomes such as this are having a serious effect on how much Picard can recover and redistribute in his "clawback" claims. The trustee's inability to recover monies near what he is seeking in these lawsuits, as well as the duration of the seemingly endless litigation, suggest an alternative solution may be welcome.

III. ASSET FORFEITURE: HISTORY, PURPOSE, AND OBJECTIONS TO ITS USE

Either criminal or civil asset forfeiture would be more efficient and cost effective than the bankruptcy system currently in place for dealing with Ponzi schemes. This Note focuses mainly on why civil asset forfeiture is a better alternative for recovering money from feeder funds or net winners, but it is necessary to discuss how criminal forfeiture is being used as a tool against Ponzi schemes as well.⁷⁸ First, this Part describes the history and purpose of asset forfeiture. Next, it discusses how asset forfeiture proceedings work, which unlawful activities allow the government to seize property, and how the government fairly redistributes that property. From there this Part discusses the advantages as well as criticisms of this approach as it relates to Ponzi schemes, and it addresses arguments that redistribution of property is best accomplished through bankruptcy proceedings involving a trustee. Finally, it dispels the criticisms that asset forfeiture is encroaching into the arena of bankruptcy and explains why asset forfeiture is a much quicker, cheaper, and all around more efficient means of accomplishing the end goal of all this litigation: quickly and fairly returning as much money as possible to the fraud victims.

77. Picard's actual fraud and willful blindness claims survived summary judgment in Judge Rakoff's court, but that does not guarantee a win at trial. In fact, Judge Rakoff in his opinion even stated that although there was enough evidence to go to trial, he was "skeptical that the Trustee can ultimately rebut the defendants' showing of good faith." *Picard v. Katz*, No. 11 Civ. 3605(JSR), 2012 WL 691551, at *1 (S.D.N.Y. Mar. 5, 2012).

78. The government is able to bring both criminal and civil forfeiture proceedings against an individual or property simultaneously or in parallel, so deciding which is better is not necessary given the scope of this Note.

A. *The History and Rationale of Civil Forfeiture*

Asset forfeiture has a long tradition in the United States dating back to English common law, but it truly rose to prominence in the 1990s.⁷⁹ The laws developed under an *in rem* theory in civil cases. *In rem*, translated as “against the thing,” permitted the government “to forfeit the property [of another] by filing a civil lawsuit against the property itself, rather than by filing an action—civil or criminal—against the property owner.”⁸⁰ This meant that “the [g]overnment could proceed against the property without having to wait until the owner was identified, apprehended and convicted.”⁸¹ Allowing the property itself to be treated as the offender in this way empowered courts to punish individuals who were, for one reason or another, “beyond the practical reach of the law and its processes.”⁸² In the 1980s and 1990s, Congress expanded civil asset forfeiture authority to include proceeds of crime and property used to commit an offense. By doing this, Congress allowed law enforcement to use asset forfeiture in most federal crimes.⁸³

This expansion also gave more power to the legal fiction that is *in rem* forfeiture. Today, “proceedings *in rem* are simply structures that allow the Government to quiet title to criminally-tainted property in a single proceeding in which all interested persons are required to file claims contesting the forfeiture at one time.”⁸⁴ Additionally, the proceedings *in rem* are still “independent of, and wholly unaffected by any criminal proceeding,”⁸⁵ and “the role of the property owner in the commission of the offense is irrelevant.”⁸⁶ The government’s ability to seize assets through civil proceedings has been limited in a few ways, specifically through the “innocent owner defense” enacted by Congress

79. STEFAN D. CASSELLA, ASSET FORFEITURE LAW IN THE UNITED STATES § 2-1, at 28 (2007); *see also* *Bennis v. Michigan*, 516 U.S. 442, 446–47 (1996) (tracing asset forfeiture laws all the way back to 1827).

80. CASSELLA, *supra* note 79, § 2-2, at 29.

81. *Id.*

82. *Id.* at 30 n.7 (quoting *Bennis*, 516 U.S. at 472 (Kennedy, J., dissenting)).

83. *Id.* § 2-4, at 33–34.

84. *Id.*; *see also* *United States v. Ursery*, 518 U.S. 267, 295–96 (1996) (Kennedy, J., concurring) (explaining that *in rem* civil forfeiture is not punishment for a criminal’s wrongdoing, and that Congress recognizes it on the theory that “in order to quiet title to forfeitable property in one proceeding, [it] has structured the forfeiture action as a proceeding against the property, not against a particular defendant”).

85. *Ursery*, 518 U.S. at 295 (Kennedy, J., concurring) (quoting *The Palmyra*, 25 U.S. 1, 15 (1827)).

86. CASSELLA, *supra* note 79, § 2-4, at 35.

following the Supreme Court's decision in *Bennis v. Michigan*.⁸⁷ In *Bennis*, the Court ruled that a vehicle used by a husband to engage in sexual acts with prostitutes could be forfeited even though the car belonged to his wife, who had no knowledge of the criminal activity.⁸⁸ The holding "did not sit well with Congress or the public," and resulted in the innocent owner defense, which is discussed in greater detail later.⁸⁹ For the most part, civil and criminal asset forfeiture is used by law enforcement as a form of punishment and deterrence against drug traffickers. But the government has recently started to extend its reach into other areas, including those historically dominated by bankruptcy courts and trustees.

B. How Asset Forfeiture Works

Unfortunately for advocates of asset forfeiture law and its many uses, the United States does not have a single, simple statute that says the government may seize any property used in or derived from a criminal act, unlike many foreign countries.⁹⁰ The most comparable statute in the United States is 18 U.S.C. § 981(a)(1)(C), which allows the United States to seize as part of civil forfeiture proceedings "[a]ny property, real or personal, which constitutes or is derived from proceeds traceable to a violation . . . of this title or any offense constituting 'specified unlawful activity.'"⁹¹ Specified unlawful activities include over 250 state, federal, and foreign crimes, making this statute very similar to a catch-all or general forfeiture statute.⁹² The most important specified unlawful activities are mail and wire fraud, as they can be charged by the federal government in nearly any crime.⁹³

87. 18 U.S.C. § 983(d) (2006) ("An innocent owner's interest in property shall not be forfeited under any civil forfeiture statute. The claimant shall have the burden of proving that the claimant is an innocent owner by a preponderance of the evidence.").

88. *Bennis v. Michigan*, 516 U.S. 442, 443–46 (1996).

89. CASSELLA, *supra* note 79, § 2-6, at 44; *see infra* Part IV.B.

90. CASSELLA, *supra* note 79, § 25-3, at 742–43. Cassella laments the fact that no such statute exists, saying that it would "be simple to enact and would end a great deal of confusion in the practice of forfeiture law." *Id.* at 743.

91. 18 U.S.C. § 981 (a)(1)(C) (2006); *see also* 18 U.S.C. § 1956(c)(7) (2006) (listing all violations of federal, state, and foreign law identified as "specified unlawful activity").

92. 18 U.S.C. § 1956(c)(7).

93. CASSELLA, *supra* note 79, § 25-3, at 743; *see also* William M. Sloan, *Mail and Wire Fraud*, 48 AM. CRIM. L. REV. 905, 905–06 (2011) ("The federal mail and wire fraud statutes are powerful tools . . . [that] have been used to prosecute a wide range of conduct.").

On March 12, 2009, Bernie Madoff pled guilty to eleven counts of criminal activity, including mail and wire fraud, along with money laundering, theft, and embezzlement—multiple offenses that are specified unlawful activities under 18 U.S.C. § 1956(c)(7).⁹⁴ This means that any property related to those specified unlawful activities is “tainted,” and may be subject to civil forfeiture. “Tainted” funds are “proceeds or property . . . derived from, or used in, committing criminal activity supporting forfeiture.”⁹⁵ The implication of this is that the assets of third parties can be subject to civil forfeiture even if the third party has not committed any crime, unlike in criminal forfeiture proceedings. For this reason, the money that the net winners and feeder funds received as part of Madoff’s Ponzi scheme may be considered criminal proceeds and therefore subject to forfeiture.⁹⁶ Currently, the government has not used forfeiture much as a tool against feeder funds and net winners. But it has recently begun to use criminal forfeiture to seize property from Ponzi scheme creators, and it seems that going after feeder funds and net winners is the next logical step, despite how much bankruptcy trustees may disagree.

*C. The Current Battle Between Asset Forfeiture
and Bankruptcy Proceedings*

Perhaps no litigation proceeding better exemplifies the current struggle between bankruptcy trustees and the government than the lawsuits against Scott Rothstein. Rothstein owned a law firm in Florida that was in actuality a giant Ponzi scheme. He was the ultimate swindler, and described as “Bronx raised, Fort Lauderdale rich, and the politicians, charities and businesses that accepted his money rarely asked where it came from.”⁹⁷ He owned, among other luxuries, a “white Lamborghini, 304 pieces of jewelry, [and] an 87-foot yacht.”⁹⁸ Once the scheme was uncovered, unsurprisingly, a number of

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94. See Transcript of Plea Hearing at 3–4, 23, *United States v. Madoff*, No. 09 CR 213 (DC) (S.D.N.Y. Mar. 12, 2009) (noting that Madoff admitted to operating a Ponzi scheme and pled guilty to all eleven counts with which he was charged). Like Madoff, most individuals convicted of running Ponzi schemes are convicted of these same charges.
95. Craig Gaumer, *A Prosecutor’s Secret Weapon: Federal Civil Forfeiture Law*, UNITED STATES ATTORNEYS’ BULLETIN, Nov. 2007, at 66.
96. See *infra* Part IV for a more detailed discussion of the possible limitations on the government’s seizing criminal proceeds currently in the hands of third parties.
97. Damien Cave, *Fraud Accusations Against Florida Lawyer Set Off a Race to Return His Donations*, N.Y. TIMES, Nov. 4, 2009, at A14. (“[H]e was known mainly for loud epithets, fast cars and big checks, written often.”).
98. Jacqueline Palank, *Prosecutors, Trustees Fight for Dominance in Ponzi Bankruptcies*, WALL ST. J. (Jan. 3, 2011, 1:01 PM), <http://online.wsj.com/article/SB10001424052748704111504576059613947208394.html>.

creditors and court-appointed trustees came out to stake a claim to all of the lavish items Rothstein had purchased, but they were too late. The assets were already in the hands of the federal government.

Battles such as this between the government and bankruptcy trustees have become much more frequent in recent years. Some people disagree with the government stepping in and seizing assets after uncovering a Ponzi scheme, as these situations have historically been handled via bankruptcy laws.⁹⁹ Yet that history has not stopped the government from “[i]ncreasingly . . . enter[ing] the formerly exclusive sphere of bankruptcy.”¹⁰⁰ Because of the government’s aggressive surge into this area, the chances of prosecutors and bankruptcy practitioners colliding with each other in court have increased significantly.¹⁰¹

As noted earlier, Picard is already colliding with New York Attorney General Eric Schneiderman over the proposed settlement with J. Ezra Merkin, a money manager who “collected hundreds of millions of dollars in management and incentive fees” from investors while he simply handed their money over to Madoff.¹⁰² Following the announcement of the \$405 million settlement,¹⁰³ Picard filed a motion for a preliminary injunction against allowing the settlement, stating that “New York should not be permitted to wreak havoc on [a] long standing federal mandate by using New York State law to give its citizens and perhaps others in a select group a jump start over all of the victims of this heinous fraud.”¹⁰⁴ Although the Attorney General Schneiferman did not seek settlement with Merkin on asset forfeiture grounds, the “turf battle” between the New York attorney general’s office and Picard over who gets first crack at individuals such as

99. John Pacenti, *Prosecutors Fear Attorney Fees May Bleed Estate: Feds Want to Take Over Distributing Firm’s Assets*, DAILY BUS. REV., July 2, 2010, at A1.

100. Jessica D. Gabel, *Midnight in the Garden of Good Faith: Using Clawback Actions to Harvest the Equitable Roots of Bankrupt Ponzi Schemes*, 62 CASE W. RES. L. REV. 19, 70 (2011).

101. Myron M. Sheinfeld, Teresa L. Maines & Mark W. Wege, *Civil Forfeiture and Bankruptcy: The Conflicting Interests of the Debtor, Its Creditors and the Government*, 69 AM. BANKR. L.J. 87, 87 (1995).

102. Reed Albergotti, *A \$410 Million ‘Turf Battle,’* WALL ST. J., Aug. 2, 2012, at C1.

103. Henriques, *supra* note 63, at B1.

104. Memorandum of Law in Support of Trustee’s Application for Enforcement of Automatic Stay and Issuance of Preliminary Injunction at 2, Picard v. Schneiderman (Bankr. S.D.N.Y. Aug. 1, 2012) (Adv. Pro. No. 08-01789 (BRL)).

Merkin is a great example of bankruptcy trustees and the government hindering each other's work.¹⁰⁵

Proponents of the status quo believe asset forfeiture is inappropriate for a number of reasons. They claim that (1) the purpose of asset forfeiture is to deal with crimes in which there are no clear victims; (2) "although returning criminal proceeds to victims is a key component of forfeiture, it isn't obligatory;"¹⁰⁶ (3) bankruptcy lawyers and courts, unlike the government, are experts in getting money back to victims; and (4) bankruptcy courts have traditionally been the tool used to redistribute victims' assets when fraud is uncovered.¹⁰⁷

The government counters by saying that bankruptcy court "is not the 'appropriate forum for marshaling and distributing assets to fraud victims.'" ¹⁰⁸ Federal prosecutors assert that they "can distribute assets faster and cheaper than bankruptcy trustees and attorneys," and that "'exorbitant' fees and costs" charged by trustees "will have a significant impact on victim recoveries."¹⁰⁹ Additionally, assigning bankruptcy trustees such as Picard to the task of recovering victim funds is the functional equivalent of giving them and their firms "winning lottery tickets."¹¹⁰ Trustees have no real clients to worry about upsetting and thus can collect enormous fees and prolong litigation for as long as they see fit. For these reasons, and because the concerns of bankruptcy advocates can easily be dealt with, the government should continue its surge into the Ponzi scheme bankruptcy sphere.

In regard to the concern that asset forfeiture is intended to be used when crime victims are unknown, asset forfeiture may be used by the government to reallocate assets for known victims of fraud just as easily as unknown victims. The purpose of asset forfeiture goes

105. See Albergotti, *supra* note 102, at C1 (discussing the lawsuit between the New York Attorney General and Picard regarding the order in which claims are paid to victims).

106. Palank, *supra* note 98.

107. Sheinfeld et al., *supra* note 101, at 101–17; *see also* Palank, *supra* note 98 (discussing the hostile battleground between bankruptcy trustees and U.S. prosecutors over which of them should have the right to seize and distribute the assets of fraud victims, particularly Ponzi scheme victims).

108. Marcus & Greenberg, *supra* note 14, at 48 (quoting Letter from Assistant U.S. Attorneys Barbara A. Ward and Sharon E. Frase to U.S. District Judge Louis L. Stanton, U.S. District Court for the Southern District of New York (April 8, 2009)).

109. *Id.* Prosecutors point to the Rothstein case as a great example in which \$2.5 million in fees had already been generated. That number is a fraction of the amount Picard and his team will earn working on the BLMIS liquidation.

110. *Id.*

beyond simply punishing and deterring criminals. It is also “the most effective means of recovering property that may be used to compensate the victims” in cases involving property offenses and fraud.¹¹¹ In fact, between 2007 and 2010 the Department of Justice (DOJ) returned over \$1.1 billion of forfeited assets to victims.¹¹² The reason for the government’s success when doing the heavy lifting in asset forfeiture cases is threefold. First, the government can “incur and defray many of the expenses associated with tracing and recovering assets at virtually no significant additional cost to the victim(s).”¹¹³ Second, the criminal and civil forfeiture tools available to the government are “very powerful” and effective at keeping criminals from dissipating assets before they are recovered.¹¹⁴ Last, the “DOJ’s ability to trace, freeze, seize and forfeit assets is truly global” and far reaching.¹¹⁵ This allows the DOJ to recover assets “based on long established mechanisms and clear treaty responsibilities,” which is important since “[c]riminals often put their ill-gotten gains in multiple jurisdictions.”¹¹⁶ Together, these abilities allow the government to retrieve more assets than their private sector counterparts such as bankruptcy trustees. Also, DOJ lawyers and the agencies they work with can do all of these things at a much cheaper price. The difference between what bankruptcy trustees receive in fees from the SIPC and what the government would receive could be allocated to victims instead, which results in a lot more money in victims’ pockets.

Proponents of using bankruptcy procedures for the recovery of assets are correct that the government has complete discretion as to whether it returns forfeited property to victims. “[B]ut it is [the] DOJ’s policy to recognize claims of legitimate victims whenever it is practical and in the interests of justice to do so.”¹¹⁷ This DOJ policy is consistent with the Crime Victims’ Rights Act, which ensures that victims of crimes receive “full and timely restitution as provided in law.”¹¹⁸ As a result, when the government seizes fraud proceeds via

111. CASSELLA, *supra* note 79, § 1-2, at 2.

112. JACK DE KLUIVER, WE ARE WITH THE GOVERNMENT AND WE ARE HERE TO HELP! 1 (2011).

113. *Id.*

114. *Id.* at 1–2.

115. *Id.* at 2.

116. *Id.* at 3.

117. *Id.* at 1; *see also* Letter from Assistant U.S. Attorneys Barbara A. Ward and Sharon E. Frase to U.S. District Judge Louis L. Stanton, U.S. District Court for the Southern District of New York, at 4 (Apr. 8, 2009) (describing how the SEC plans to cooperate with the DOJ and SIPC and that all of the assets recovered from Madoff will be distributed properly to the victims and creditors).

118. 18 U.S.C. § 3771(a)(6) (2006).

forfeiture, as it often does in response to Ponzi schemes, it takes the forfeited monies and, in proceedings administered by the Attorney General, distributes the funds to all victims on a pro-rata basis.¹¹⁹

The government returns forfeited assets through two processes known as remission and restoration. The remission process begins with the government notifying all known victims of the crimes that led to the forfeiture.¹²⁰ After receiving notice, the victims may file petitions to have the forfeited assets returned to them, so long as they meet certain eligibility requirements under the Code of Federal Regulations.¹²¹ The restoration process is similar to remission, but it is faster and does not require victims to file a petition.¹²² Because of this, restoration is “particularly beneficial in large multiple-victim cases.”¹²³ These processes are inexpensive and effective tools that the government uses to redistribute assets to victims.¹²⁴ Thus, bankruptcy proponents need not worry about whether the government is capable of recovering assets quickly and returning them where they belong.

IV. TAKING IT A STEP FURTHER: FORFEITURE OF FEEDER FUND AND NET WINNER PROCEEDS

Not only is asset forfeiture the best way to handle recovery and redistribution of funds from the individuals responsible for creating the Ponzi scheme, but it is also the best and most efficient way to fairly retrieve and redistribute funds from third parties such as feeder funds and net winners. The reasons are essentially the same as those discussed earlier regarding the current battles between the government and bankruptcy trustees.¹²⁵ There are, however, some unique features about a SIPA trustee such as Picard that make asset forfeiture even more attractive. Those factors include an incredibly lucrative fee structure for the trustee and his colleagues, as well as an environment that lacks any sort of accountability. But before discussing the reasons

119. MONEY LAUNDERING SECTION, U.S. DEP'T OF JUSTICE, ASSET FORFEITURE POLICY MANUAL 108 (2008), *available at* <http://www.justice.gov/criminal/foia/docs/2008policy-manual.pdf>.

120. *Id.*

121. *See* 28 C.F.R. § 9.8 (2010).

122. DE KLUIVER, *supra* note 112, at 7.

123. *Id.*

124. Jack de Kluiver, Acting Assistant Deputy Chief of the Asset Forfeiture and Money Laundering Section of the DOJ, puts the advantages of having the U.S. government help fraud victims nicely, stating that it “might not be practical or possible all the time, but it certainly can be cheaper, more effective, . . . and usually will give . . . client[s] a broader reach than . . . civil proceedings.” *Id.* at 8.

125. *See supra* Part III.C.

why asset forfeiture is the best tool for recovering fees and fictitious profits from feeder funds and net winners, an important question must be answered: Is it even possible?

A. *Why Asset Forfeiture Can Be Used to Recover and Redistribute Money from Feeder Funds and Net Winners*

The first prerequisite for a forfeiture case to begin is probable cause. In an asset forfeiture situation the probable cause standard is the same as it would be for any other case.¹²⁶ Using a totality of the circumstances approach, there must be “a ‘fair probability’ that the property was derived from, used to commit, or otherwise involved in the commission of an act giving rise to forfeiture under the applicable statute.”¹²⁷ The applicable statutes that govern seizure of property for asset forfeiture in a case such as BLMIS’s Ponzi scheme are 18 U.S.C. § 981(b) for civil forfeiture and 21 U.S.C. § 853 for criminal forfeiture. Of the two, 18 U.S.C. § 981(b) is more commonly used, as most forfeiture proceedings begin as civil forfeitures.¹²⁸

The government is able to seize the money involved in a Ponzi scheme like Madoff’s because that money was “involved in the commission of an act giving rise to forfeiture.”¹²⁹ Those acts are the charges Madoff was convicted of, including mail fraud, wire fraud, theft, and embezzlement.¹³⁰ These crimes are considered specified unlawful activities under 18 U.S.C. § 981(a)(1)(C), and therefore commission of them makes all property involved subject to criminal or civil forfeiture.¹³¹ Together, the money laundering violation under 18 U.S.C. § 1956 and the specified unlawful activities violations make all proceeds involved in Madoff’s Ponzi scheme subject to civil forfeiture.¹³²

126. CASSELLA, *supra* note 79, § 3-3, at 96; *see* United States v. Real Property 874 Gartel Drive, 79 F.3d 918, 922 (9th Cir. 1996) (“The standard of probable cause to support forfeiture is similar to that required to obtain a search warrant.”).

127. CASSELLA, *supra* note 79, § 3-3 at 96 (quoting United States v. One 1987 Mercedes Benz 300E, 820 F. Supp. 248, 251 (E.D. Va. 1993)) (other citations omitted).

128. *Id.* § 3-2, at 94.

129. *Id.* at 96.

130. *See supra* Part III.B.

131. *See* 18 U.S.C. §§ 981(a)(1)(A)–982(a)(1) (2006) (stating that all property involved in violation of 18 U.S.C. §§ 1956–1957 is subject to forfeiture). Specified unlawful activities are defined as “any act or activity constituting an offense listed in section 1961(1),” which includes mail and wire fraud, embezzlement, and theft. 18 U.S.C. § 1956(c)(7).

132. A great example of how specified unlawful activity proceeds and property involved in money laundering are subject to forfeiture can be seen in United States v. Iacaboni, 363 F.3d 1 (1st Cir. 2004). The defendant was convicted of conspiring to conduct a gambling operation,

Thus, as long as the government can trace the exact proceeds from Madoff directly to feeder fund and net winner accounts, they are forfeitable to the government.

The idea of tracing proceeds is very important when seizing the assets of third parties such as these since “the Government has to show that the particular property—not some other property that happens to belong to the same person—was derived from, or used to commit or facilitate, the underlying offense.”¹³³ This is unlike criminal forfeiture, in which the government can substitute untainted property of the defendant “for the directly forfeitable property.”¹³⁴ This potential drawback has an advantage though, as it allows the government to seize assets of third parties who were not in any way a part of a crime and return them to victims. Since only the property itself is named as the defendant, it is subject to forfeiture no matter who is in possession of it, so long as it can be traced back to a forfeitable crime and the owner does not have an affirmative defense as an “innocent owner.”¹³⁵

Unfortunately, this tracing requirement makes forfeiture against feeder funds and net winners in the current Madoff case nearly impossible. Since the fraud was uncovered in 2008, these entities have surely moved proceeds they received from the scheme to hundreds of different places. But as future Ponzi schemes are uncovered, tracing the proceeds should be much easier.¹³⁶ As soon as the fraud is

a specified unlawful activity, as well as money laundering in violation of 18 U.S.C. § 1956(a)(1)(A)(i). The defendant

received hundreds of thousands of dollars in bets at his house, ran the gambling operation from there, and dispensed a portion of the proceeds to his employees. Some of the money he disbursed was for the employees’ salaries and expenses, and some was to pay off the winning bettors, but all of it was disbursed for the purpose of promoting the continuation of the gambling scheme. Thus, the payments constituted promotion money laundering, and the money involved in those payments . . . was ordered forfeited as property involved in the offense.

CASELLA, *supra* note 79, § 27-8, at 808.

133. CASELLA, *supra* note 79, § 11-3(b), at 389.

134. *Id.* § 19-4, at 575. For example, “[i]f a wrongdoer used a blue 1993 Pontiac with a certain VIN number to commit [an] offense, the Government must name *that car* as the defendant *in rem*, and it must prove that *that car* is subject to forfeiture. It cannot bring the forfeiture action against a red Chevrolet of equal value that belongs to the same owner,” which it could do in a criminal forfeiture proceeding. *Id.* § 11-3(b), at 389–90.

135. *Id.* § 12-1, at 407.

136. Ponzi schemes and other massive fraud crimes are likely to continue being discovered in large numbers as “[t]he drying up of money caused

uncovered, the government can freeze the assets of any investors involved in the scheme, trace the funds they withdrew from it, and then seize the funds as proceeds of crime to be redistributed to victims on a pro-rata basis.

B. The Innocent Owner Defense

Another hurdle the government must get over to seize the proceeds taken by feeder funds and net winners is the innocent owner defense. The defense was developed by Congress as a response to Supreme Court cases such as *Bennis*,¹³⁷ in which the Court held that

the Due Process Clause of the Fourteenth Amendment and the Takings Clause of the Fifth Amendment do not protect property owners from the forfeiture of their property, when the property was used to commit a criminal offense, even if the property owner had no knowledge of, and did not consent to, the illegal use of the property.¹³⁸

Since civil forfeiture is directed at the property itself, not the owner, “the role of the owner in the underlying offense was historically considered to be irrelevant.”¹³⁹ The rationale behind such a decision was twofold. First, it was “in the public interest for the Government to remove the instruments [and proceeds] of crime from circulation,” and second, it “encourage[d] property owners to take greater care lest their property be used for an unlawful purpose.”¹⁴⁰

Despite the Court’s rulings, Congress and the DOJ still felt a change in the law was necessary. In 1996, the DOJ submitted a proposal to Congress that would establish “a uniform innocent owner defense that would apply to virtually all civil forfeiture actions undertaken under federal law.”¹⁴¹ The result was the Civil Asset Forfeiture Reform Act of 2000 (CAFRA),¹⁴² which established affirmative defenses for individuals with both preexisting and after-acquired property subject to forfeiture.¹⁴³

by the recent financial crisis has unearthed numerous Ponzi schemes nationwide.” Marcus & Greenberg, *supra* note 14, at 48.

137. *Bennis v. Michigan*, 516 U.S. 442 (1996).

138. Stefan D. Cassella, *The Uniform Innocent Owner Defense to Civil Asset Forfeiture*, 89 KY. L.J. 653, 654 (2001).

139. CASSELLA, *supra* note 79, § 12-1, at 408.

140. *Id.* § 2-6, at 39.

141. Cassella, *supra* note 138, at 655.

142. Pub. L. No. 106-185, 114 Stat. 202 (codified at 18 U.S.C. § 983 (2006)).

143. 18 U.S.C. § 983(d)(2)–(3).

For either situation, the innocent owner bears the burden of proving by a preponderance of the evidence that he or she is in fact an innocent owner of the property in question.¹⁴⁴ This means that once the government establishes the forfeitability of the property, it does not have to “put on any evidence negating the [innocent owner] defense during its case-in-chief.”¹⁴⁵ If an individual chooses to produce evidence of preexisting innocent ownership, the elements he or she must prove are straightforward: ownership and innocence when the crime was committed.¹⁴⁶ Although many of the individuals who invest in Ponzi schemes are innocent, they will most likely no longer be considered owners of their funds. Once an individual or entity turns funds over to a Ponzi scheme for investment, it loses its ownership rights in those funds because it no longer exercises “dominion or control over the property,” and may additionally be considered an unsecured creditor.¹⁴⁷ If the funds are used to commit mail or wire fraud, for example, the government immediately gains a forfeiture interest in them as proceeds of crime, and that interest trumps any claim from the previous owners. This process is known as the relation-back doctrine.¹⁴⁸ However, the more relevant innocent owner defense in regard to seizing money from feeder funds and net winners is the one that deals with after-acquired property interests.¹⁴⁹

A provision of CAFRA deals with alleged property interests of claimants “acquired after the conduct giving rise to the forfeiture has taken place.”¹⁵⁰ Section 983(d)(3) provides that individuals may have an affirmative defense as an “innocent owner” if at the time they acquired an interest in the property they “(i) [were] a bona fide purchaser or seller for value . . . and (ii) did not know and [were] reasonably without cause to believe that the property was subject to

144. See § 983(d)(1) (“The claimant shall have the burden of proving that the claimant is an innocent owner by a preponderance of the evidence.”).

145. CASSELLA, *supra* note 79, § 12-3, at 410–11.

146. 18 U.S.C. § 983(d)(2)(A).

147. See § 983(d)(6)(B) (stating that the term “owner” does not include “a person with only a general unsecured interest in, or claim against, the property or estate of another . . . [or] a nominee who exercises no dominion or control over the property”).

148. See 21 U.S.C. § 853(c) (setting forth the relation back doctrine, which states that the government’s interest in forfeitable property vests when the crime giving rise to forfeiture is committed, and therefore a third party can only prevail against that interest if he or she had an interest in the property before the offense or acquired it afterward as a bona fide purchaser for value).

149. 18 U.S.C. § 983(d)(3).

150. *Id.*

forfeiture.”¹⁵¹ Courts have interpreted the bona fide purchaser provision as having come from commercial law.¹⁵² This means that “to be a ‘purchaser,’ the claimant must give something of value in exchange for the property interest.”¹⁵³ Courts have not established exactly what makes a bona fide purchaser in civil proceedings, but generally they follow the bona fide purchaser provision in the criminal forfeiture statute,¹⁵⁴ since it is nearly identical to the innocent owner defense in the civil forfeiture statute.¹⁵⁵ In fact, the statutes are so similar that “case law interpreting one statute will apply to the other in most cases.”¹⁵⁶ Generally, the case law holds that family members and donees cannot be bona fide purchasers.¹⁵⁷ Some courts have also held that not only must value be given for the purchase but the value also must be equivalent.¹⁵⁸ The feeder funds and net winners would

151. *Id.*

152. *See, e.g.,* United States v. Harris, 246 F.3d 566, 575 (6th Cir. 2001) (stating that the bona fide purchaser provision comes from “hornbook commercial law”).

153. CASSELLA, *supra* note 79, § 12-6, at 433–34; *see also* United States v. One 1996 Vector M12, 442 F. Supp. 2d. 482, 486 (S.D. Ohio 2005) (stating that the term bona fide purchaser includes “all persons who give value . . . in an arms’-length transaction with the expectation that they would receive equivalent value in return” (alteration in original) (quoting 21 U.S.C. § 853(n)(6)(B))).

154. *See* 21 U.S.C. § 853(n)(6)(B) (“[T]he petitioner is a bona fide purchaser for value of the right, title, or interest in the property and was at the time of purchase reasonably without cause to believe that the property was subject to forfeiture under this section.”).

155. CASSELLA, *supra* note 79, § 23-16, at 712.

156. *Id.*

157. *See, e.g.,* United States v. McHan, 345 F.3d 262, 279 (4th Cir. 2003) (finding that a wife who obtained property from her husband in a non-arm’s-length transaction was not a bona fide purchaser); United States v. McCorkle, 143 F. Supp. 2d 1311, 1321–22 (M.D. Fla. 2001) (holding that organization could not contest forfeiture of a car donated as a gift by the defendant); United States v. Brooks, 112 F. Supp. 2d 1035, 1041 (D. Haw. 2000) (holding that a wife was not a bona fide purchaser of her husband’s forfeited assets simply because she contributed uncompensated services that increased the value of the marital estate). An arm’s-length transaction is defined as a “transaction between two unrelated and unaffiliated parties” or a “transaction between two parties, however closely related they may be, conducted as if the parties were strangers, so that no conflict of interest arises.” BLACK’S LAW DICTIONARY 1635 (9th ed. 2009).

158. *See, e.g.,* CASSELLA, *supra* note 79, § 23-16(b), at 713 n.174 (“[A] third party, who obtains an interest in insolvent defendant’s property without giving something of equivalent value, is engaged in a fraudulent conveyance, and thus, cannot be a bona fide purchaser under state law.” (citing United States v. Frykholm, 362 F.3d 413, 417 (7th Cir. 2004)));

have to claim they were bona fide purchasers under this after-acquired interest provision, as they obtained their interest in Madoff's funds and fictitious profits after the fraud had begun. The feeder funds would likely argue they were bona fide purchasers since they provided BLMIS with the service of recruiting investors to the company in exchange for fees. Net winners would also claim that the fees they gave to BLMIS and the feeder funds to invest their money qualify them as bona fide purchasers with regard to the fictitious profits they received. Despite these arguments, the government may still claim the nominal fees paid by the net winners and services provided by the feeder funds are not of equivalent value to the forfeitable proceeds they received from the Ponzi scheme.¹⁵⁹ The government may also argue that the fees paid by net winners in exchange for the investment of their money do not qualify them as bona fide purchasers of a service and entitle them to fictitious profits, since there was no actual investing being done.

Even if the courts decide both the feeder funds and net winners are bona fide purchasers, the government may still seize their property if it can show they both were not "reasonably without cause to believe that the property was subject to forfeiture."¹⁶⁰ This additional requirement in the statute means that "[a] third party who acquires an interest in the forfeited property after the act giving rise to the forfeiture must show that he had no reason to know that the property was involved in a crime committed by another person."¹⁶¹ Therefore, any third party who obtains property and has or should have reason to believe it was used to commit an offense cannot challenge the forfeiture.¹⁶² Additionally, it does not matter how the third party became aware that the property was attached to a crime for which it could be subject to forfeiture, whether it be "first-hand knowledge, from reports in the media, or because the property was named in an indictment."¹⁶³ The

see also United States v. 198 Training Field Rd., No. Civ.A. 02-11498-GAO, 2004 WL 1305875, at *2 (D. Mass. June 14, 2004) (noting that a mother who received property from her son in exchange for \$1 was not a bona fide purchaser).

159. *See* United States v. One 1996 Vector M12, 442 F. Supp. 2d 482, 487 (S.D. Ohio 2005) (holding that the claimant must show he gave something of equivalent value for the property subject to forfeiture). Any fees paid by the Mets' owners to BLMIS were most likely not equivalent to the \$1 billion sought by Picard, all of which may have been civilly forfeitable. *See supra* Part II.B.

160. 18 U.S.C. § 983(d)(3)(A)(ii) (2006).

161. CASSELLA, *supra* note 79, § 12-6(b), at 437.

162. *Id.*

key question is whether the information available to the third party would “put a reasonable person on notice that the property was subject to forfeiture.”¹⁶⁴

This provision is another way for the government to obtain the right to seize proceeds from feeder funds and net winners. The government can make a strong case that reasonable financially sophisticated entities such as the feeder fund investment banks should have been on notice that some sort of crime was being committed. Picard, in his complaints against these feeder funds, has in fact already done this.¹⁶⁵ He argues that not only did the feeder funds fail to perform the proper due diligence required before recruiting people to invest with BLMIS but that they also were willfully blind to numerous red flags that were brought to their attention.¹⁶⁶ For instance, in 2004 HSBC issued a due diligence report regarding Madoff’s track record, noting that it was “[t]oo good to be true.”¹⁶⁷ Also, bankers at JPMorgan concluded that they had “only a faxed confirmation from Mr. Madoff that trades were occurring, but couldn’t verify it.”¹⁶⁸ Although Picard’s claims against these feeder funds were dismissed for lack of standing,¹⁶⁹ the government could use the same arguments to prove that the funds were on notice that the fees they were awarded from BLMIS were subject to forfeiture. Additionally, these same arguments can be made against wealthy, financially sophisticated net winners such as the Mets owners. Anyone else could still be subject to forfeiture if he or she pulled out their money as soon as they saw the “writing on the wall” about BLMIS’s inevitable collapse. These claims that the government would have to prove to seize the property of feeder funds and net winners are very similar to what Picard is trying to prove in his lawsuits as trustee anyway.

Whether it is because they were not bona fide purchasers or because a reasonable person would have suspected BLMIS was committing a crime, the government should be able to recover funds subject to civil asset forfeiture from feeder funds and net winners.

163. *Id.*; see also 198 *Training Field Rd.*, 2004 WL 1305875, at *2 (holding that reading in a newspaper that drugs had been seized from the property gave a claimant knowledge that the property was subject to forfeiture).

164. CASSELLA, *supra* note 79, § 12-6(b), at 438.

165. See *supra* Part I.B.1 and note 30.

166. See HSBC Bank Amended Complaint, *supra* note 11, at 52 (“The red flags were shocking not only for what they demonstrated about Madoff’s investment strategy, but also for what they demonstrated about the depth of the Defendants’ awareness of the fraud.”).

167. *Id.* at 108 (alteration in original).

168. Michael Rothfeld, *Trustee: J.P. Morgan Abetted Madoff*, WALL ST. J., Feb. 4, 2011, at A2.

169. See *supra* Part II.A.

Proof of their ability to recover can already be seen in settlements reached between Picard, the federal government, and longtime Madoff investor Jeffrey Picower. The \$7.2 billion settlement agreement with Picower's estate provides that \$5 billion will go to Picard while \$2.2 billion is claimed by the U.S. Attorney's office under a civil forfeiture agreement.¹⁷⁰ Lastly, even if the government is unable to recover all it seeks under asset forfeiture laws due to things like innocent owner claims, at least it will be at a much more reasonable cost than a SIPA trustee would charge.

C. Asset Forfeiture: Cheaper, Faster and All-Around More Efficient

The reason why the government should handle recovery and distribution of assets from feeder funds and net winners as opposed to trustees such as Picard can be summed up in one word: efficiency. By allowing the government to take charge of cleaning up messes such as the one left by Madoff, a resolution can be reached for a fraction of what it costs to employ Picard and his colleagues. Secondly, the government and the entire DOJ have much more of an incentive to end cases as quickly as possible and allow all the individuals and entities involved in these tragic circumstances to move on with their lives. The U.S. Attorneys have heavy case loads and lack any financial incentive to bring frivolous forfeiture claims or keep cases going longer than is necessary. Lastly, one must consider the power of the U.S. government and its incredible global reach to freeze and seize assets. For these reasons, asset forfeiture needs to be considered as an alternative to expensive bankruptcy proceedings following the discovery of Ponzi schemes.

For his legal services, Irving Picard bills at a rate of \$742.50 an hour.¹⁷¹ By the end of 2010 his firm, Baker & Hostetler, was paid almost \$3.3 million for just his services, a figure that does not take into account fees paid to lawyers and consultants with whom he is working in order to litigate more than 1,000 lawsuits.¹⁷² In the four-month period ending January 31, 2011, Picard and Baker & Hostetler

170. Chad Bray, *Challenge to Picower Pact Is Dismissed by Judge*, WALL ST. J., Mar. 27, 2012, at C2.

171. Rothfeld, *supra* note 29, at B1. Some estimates put the amount even higher. See Andrew Ross Sorkin, *Madoff Case Is Paying Off for Trustee (\$850 an Hour)*, N.Y. TIMES DEALBOOK (May 28, 2012, 9:42 PM), <http://dealbook.nytimes.com/2012/05/28/madoff-case-is-paying-off-for-trustee-850-an-hour> (claiming Picard charges closer to \$850 an hour for his services).

172. Rothfeld, *supra* note 29, at B1. Rothfeld asserts that by 2014 Picard alone will have billed about \$16 million in legal fees. But if you consider all those who are working with him on the lawsuits, the total cost approaches \$1.4 billion by 2014. *Id.*

requested that a judge approve a \$43.7 million legal bill.¹⁷³ And the fees do not show any signs of subsiding. From February 1, 2011 to May 31, 2011 Picard's firm billed \$44.7 million, with Picard personally claiming \$600,000 in legal fees.¹⁷⁴ And as of September 2012, the firm is seeking approval from the bankruptcy court for another \$60 million.¹⁷⁵ Even Picard himself does not believe he and his firm will stop collecting fees any time soon, estimating that by 2014 they will reach \$1 billion.¹⁷⁶ Through October 31, 2011 the total cost of all Madoff liquidation expenses was \$452 million.¹⁷⁷ These extraordinary figures are the result of 285 lawyers working on the Madoff cases at an average rate of \$437.89 per hour and 66 paralegals and staffers at a rate of \$250 per hour, "as they scour[] the earth to recover money and assets stolen by Madoff."¹⁷⁸ Seeing these whopping figures makes it impossible not to wonder if these funds could be used in a more beneficial way.

Before discussing a better use for the expected \$1 billion in legal fees, it is important to identify where the funds come from, as they do not come out of the pool of money recovered by Picard. A trustee like Picard caught up in bankruptcy proceedings of this type is paid directly by the SIPC after he or she files an application for allowances and the court approves it, but there is no real oversight as to how

173. See Aaron Smith, *Madoff: The \$43 Million Legal Bill*, CNN MONEY (May 17, 2011, 4:54 PM), http://money.cnn.com/2011/05/13/news/companies/madoff_trustee_cost/index.htm (discussing the scope and costs of the Madoff litigation).

174. See Peter Lattman, *Bill for Madoff Trustee Rises to \$224 Million*, N.Y. TIMES DEALBOOK (Sept. 22, 2011, 7:45 AM), <http://dealbook.nytimes.com/2011/09/22/bill-for-madoff-trustee-rises-224-million> (discussing the steady fees requested by Picard and approved by the bankruptcy judge in charge of the case).

175. See Jacqueline Palank, *Madoff Payout: \$2.4 Billion*, WALL ST. J., Aug. 23, 2012, at C3 (noting Picard's latest request for additional fees at a discounted rate after receiving court approval to disperse \$2.4 billion in recovered funds to Madoff's investors).

176. See Sorkin, *supra* note 171 ("And how much does Mr. Picard estimate the fee spigot will pour out by 2014? A mere \$1 billion.").

177. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 12-414, INTERIM REPORT ON THE MADOFF LIQUIDATION PROCEEDING 31 (2012) ("Through October 31, 2011, [Picard] reported spending of \$451.8 million for liquidation activities. . . . [T]he two major components have been legal costs, chiefly for time spent by the Trustee and his counsel, and consultant costs, for work such as investigating fraudulent activities of the Madoff firm and analyzing customer accounts."). The report estimates that total legal costs will exceed \$1 billion. *Id.*

178. Smith, *supra* note 173.

much the trustee may charge.¹⁷⁹ The SIPC obtains funding by requiring all broker-dealers in the United States to register with the SIPC, and pay into its fund by means of an annual fee. The fee is determined after the SIPC consults with self-regulatory organizations and determines how much funding it will require to cover any necessary payments or loans.¹⁸⁰ In 2009 the SIPC increased assessments for membership, bringing current annual fee collections to between \$400 and \$450 million.¹⁸¹ Still, although it may be comforting to know trustees are being paid by the broker-dealers themselves rather than by victims whose assets are recovered, it does not change the fact that SIPC fees could go directly to victims if a tool such as asset forfeiture were used to recover and redistribute funds.

Another concern about the large fees being charged by trustees and firms such as Picard and Baker & Hostetler involves the SIPC running out of money. Although the membership fees charged to the broker-dealers may seem like a lot, the current rate at which trustees are being paid is creating a growing fear in Congress that the SIPC may soon become insolvent.¹⁸² The fear is especially apparent in this current economic climate, with high-profile liquidations involving firms such as BLMIS and Lehman Brothers. Enormous bankruptcies such as these may cause the SIPC, an important investor protection organization, to go bankrupt due to excessive trustee fees. This made a number of lawmakers angry and worried about the SIPC's oversight (or lack thereof) regarding these types of legal service payments. In a letter to the SEC, Congressmen Peter King and Gary Ackerman urged the commission to implement the Office of Inspector General's

179. See 15 U.S.C. § 78eee(b)(5)(A)–(C) (2006) (“The court shall grant reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred (hereinafter in this paragraph referred to as ‘allowances’) by a trustee, and by the attorney for such a trustee, in connection with a liquidation proceeding. . . . In any case in which such allowances are to be paid by SIPC without reasonable expectation of recoupment thereof as provided in this chapter and there is no difference between the amounts requested and the amounts recommended by SIPC, the court shall award the amounts recommended by SIPC.”).

180. *Id.* at § 78ddd(c).

181. See Dan Jamieson, *Lawmakers Slam SIPC over Trustee Fees*, INVESTMENT NEWS (Apr. 12, 2011 4:37 PM), <http://www.investmentnews.com/article/20110412/FREE/110419972> (“The SIPC fund now has \$1.3 billion, even after paying \$800 million to Madoff customers.”).

182. See *id.* (stating that New York congressmen are worried about the lack of oversight concerning fees at the SIPC, and they believe that the trustee is driven by profit rather than a desire to help defrauded investors get their money back and that current law should be changed to allow courts to reject fee requests originally approved by the SIPC).

audit report concerning the oversight of SIPC activities.¹⁸³ The audit and letter both voiced concerns over the “few, if any, limits on the fees that may be awarded” to independent court-appointed trustees such as Irving Picard.¹⁸⁴ The inspector General’s report recommended that the SEC take action to fix a number of problems through additional oversight.¹⁸⁵ Specifically, the report asked the commission to “negotiate with outside court-appointed trustees more vigorously to obtain a reduction in fees greater than 10 percent,” and deal with reports that Picard has “retained public relations advisors and other consultants whose role in aiding defrauded investors is questionable at best.”¹⁸⁶ Lawmakers are predominantly worried that “the trustee may be driven by profit rather than the goal of ensuring that the defrauded investors are made whole.”¹⁸⁷

Congress is not the only group critical of the massive fees being racked up by Picard in this litigation. Many of the attorneys who represent the defendants in the clawback actions are upset as well. As stated by Helen Chaitman, an attorney with Becker & Poliakoff and representative of more than 800 former BLMIS customers, “Picard is going to wind up being richer than Madoff.”¹⁸⁸ The real worry is not what Picard has received in compensation so far, but rather his fee potential. Many of these cases have continued and will continue to go on for many years. This leads to another major criticism of

183. See Letter from Peter T. King & Gary L. Ackerman, U.S. Congressmen, N.Y., to Mary L. Schapiro et al., Chairman, SEC (Apr. 12, 2011), available at <http://ackerman.house.gov/uploads/11.04.12SECletter.pdf>.

184. *Id.* (quoting OFFICE OF INSPECTOR GENERAL, REPORT NO. 495, SEC’S OVERSIGHT OF THE SECURITIES INVESTOR PROTECTION CORPORATION’S ACTIVITIES vii (2011) [hereinafter INSPECTOR GENERAL REPORT]).

185. *Id.*

186. *Id.* (quoting INSPECTOR GENERAL REPORT, *supra* note 184, at 27).

187. Jamieson, *supra* note 181.

188. Wayne Coffey, Teri Thompson & Michael O’Keeffe, *For Picard, Lawsuit Pays: Madoff Trustee Reaps Millions*, NEW YORK DAILY NEWS, May 25, 2011, at 62; see also Objection to Sixth Application of Trustee and Baker & Hostetler LLP for Allowance of Interim Compensation for Services Rendered and Reimbursement of Expenses Incurred from October 1, 2010 through January 31, 2011, Securities Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (*In re Bernard L. Madoff*), 474 B.R. 76 (Bankr. S.D.N.Y. 2012) (No. 08-01789 (BRL)) (objecting to the large fees being paid out to Picard and claiming that he has violated federal law by, among other things, suing innocent investors, failing to report on BLMIS’s crimes, and reaching “sweetheart” deals with Madoff’s co-conspirators); Sorkin, *supra* note 171 (“At \$850 an hour, Mr. Picard and his law firm . . . are starting to look more like the princes of the Full Employment Act for Lawyers than storybook heroes.”).

bankruptcy trustees—lack of oversight and incentive to finish litigation quickly. Picard and other bankruptcy trustees are not accountable to a real client who may get tired of paying exorbitant fees.¹⁸⁹ The only real oversight is a requirement that all fees be approved by the bankruptcy judge presiding over the cases, but judges tend to sign off on fee requests without much resistance.¹⁹⁰ These facts mean that, as Chaitman puts it, “[a]ssuming my information is correct . . . [Picard] certainly has an incentive to increase legal fees in the liquidation and to keep it going as long as possible.”¹⁹¹ Without a real client to question charges, a trustee is also free to hire whomever he wants, including accountants and consultants, without any concern about repercussions.

Although Picard may come off as a “bad guy” given the money he will take home at the end of all this litigation, in reality he is simply doing his job as the court-appointed trustee for this extremely complex and seemingly endless liquidation process. His duty is to “assemble the largest Customer Fund and General Estate possible” for victims, and he is doing that as well as anyone could have expected.¹⁹² As of September 2012 he has recovered \$9.1 billion of the estimated \$17.3 billion of principal stolen from investors in Madoff’s fraud, \$2.4 billion of which was recently approved for distribution to victims.¹⁹³ That \$2.4 billion distribution was in addition to \$330 million already recovered and \$800 million in advances from the SIPC for hardship cases.¹⁹⁴ The remainder of the \$9.1 billion recovered through settlements remains tied up in appeal processes and it is “unclear whether some of the settlements . . . will hold up,” although

189. *Cf. Morrison v. Olson*, 487 U.S. 654, 731 (1988) (Scalia, J., dissenting) (explaining that when a single person is given power, it is important that he or she be held accountable in some way so that “blame can be assigned to someone who can be punished”). If a SIPA trustee is not held accountable by anyone, what is to keep him from receiving his fees and in turn keeping litigation going as long as he can?

190. *See* Lattman, *supra* note 174 (claiming that as of May 31, 2011, all of Picard’s fees had been approved by the judge overseeing the Madoff litigation without argument).

191. Coffey et al., *supra* note 188, at 62.

192. Picard, *supra* note 28.

193. *See* Palank, *supra* note 175, at C3 (stating that Picard believes this latest distribution is a major milestone in the global hunt for stolen funds).

194. *See* Linda Sandler, *Madoff Costs Surpass Victim Payouts as Strategy Fails*, BLOOMBERG (Apr. 30, 2012 12:00 AM), <http://www.bloomberg.com/news/2012-04-30/madoff-costs-surpass-victim-pay-offs-as-strategy-lies-in-ruins.html> (noting setbacks in Madoff investors’ recovery while administrative costs continue to rise).

Picard is confident that the appeals will fail.¹⁹⁵ Unfortunately, even if Picard receives permission to distribute the remaining \$9.1 billion he has recovered, it is unlikely he will obtain the full \$17.3 billion in principal, “let alone the \$100 billion he originally sought” to recover when the liquidation process began.¹⁹⁶ Even the SIPC does not believe he will recover all of the estimated principal, stating that “based on current Trustee assets, lawsuits filed, and the estimated possibilities for recoveries arising from [the] litigation, SIPC senior management does not now expect this level of recoveries to occur.”¹⁹⁷ In light of this information, asset forfeiture becomes an intriguing alternative to the trustee process, as it would be less expensive, take less time, and obtain at least similar results.

The government, unlike trustees such as Picard, has clients—American taxpayers—to answer to. U.S. attorneys do not charge the enormous hourly fees that the trustee and his colleagues have collected, which means they have no incentive to extend litigation longer than is necessary. Finally, the government’s ability to freeze and seize assets is fast acting and global.¹⁹⁸ As soon as a major Ponzi scheme or other fraud is uncovered, they can begin collecting assets for redistribution. In the end, the government’s ability to seize and redistribute monies from feeder funds and net winners quickly and efficiently makes asset forfeiture a much smarter option than bankruptcy proceedings following the discovery of a Ponzi scheme.

CONCLUSION

It would be naïve to think everyone will find either clawbacks by a trustee or forfeiture of assets by the government to be fair and equitable ways of dealing with situations such as these, but they truly are. This becomes apparent when they are looked at from the perspective of the Madoff investors as a whole. Though the net winners have a legitimate gripe about being forced to return funds many of them believed were rightfully theirs, they begin to look like “someone who upon discovering the money he has obtained ha[d] been stolen, refuses to return it to its rightful owner.”¹⁹⁹ The lack of fairness in a situation like that is palpable, and “[e]ach time a court grants a winning investor the full extent of his winnings, every other

195. Sorkin, *supra* note 171.

196. *Id.*

197. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 177, at 47.

198. *See supra* notes 111–16 and accompanying text.

199. Gabel, *supra* note 100, at 76. Gabel goes on to say that “in that case, [a claim] that the unwitting thief felt so secure in his newfound wealth that it is wrong to take it from him, would fall on deaf ears in most courts.” *Id.* at 76–77.

investor is pushed further away from the full return of his or her principal.”²⁰⁰ There is no reason why people like Natalie Erger and her family should be left with nothing simply because they did not act quickly enough, or get lucky, like the net winners did. None of these investors will ever be made completely whole again. But the fairest way of dealing with circumstances such as these is to get each investor as much of their principal back as possible. In fact, courts have agreed with this interpretation, selecting the “Net Investment Method” as the preferred way of returning funds to investors rather than the “Last Statement Method.”²⁰¹ The adoption of the Net Investment Method means a trustee like Picard can determine which investors may recover money lost in the Ponzi scheme by “subtracting the amount withdrawn from an investor’s account from the total placed with Madoff.”²⁰² The court states that this method is far more equitable than the Last Statement Method, which would “have the absurd effect of treating fictitious and arbitrarily assigned paper profits as real.”²⁰³ Rulings such as this show that Picard’s actions are proper, but allowing the government to do it instead is a much more efficient alternative. Forfeiture of proceeds received by feeder funds and net winners accomplishes the same goal as that sought by the bankruptcy trustee, yet has the additional benefit of limiting costs, maximizing recovery, and quickening the process as a whole. The result would still be a largely upset or unsatisfied group of victims, but at least they would have most of their principal back and the ability to quickly forget their tragedies ever happened and move on with their lives.

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200. *Id.* at 79.

201. *See In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 235 (2d Cir. 2011) (“[T]he Net Investment Method was more consistent with the statutory definition of ‘net equity’ than any other method advocated by the parties or perceived by this Court.”).

202. Bob Van Voris & Linda Sandler, *Madoff Trustee Wins Appeals Court Ruling on Calculating Investors’ Losses*, BLOOMBERG (Aug. 16, 2011 4:21 PM), <http://www.bloomberg.com/news/2011-08-16/madoff-trustee-wins-appeals-court-ruling-on-calculating-investors-losses.html>.

203. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 235.

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