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Evil Has a New Name (And a New Narrative): Bernard Madoff

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INTRODUCTION

Any lawyer knows that in order to win a trial, whether civil or criminal, one has to tell a story that the jury understands.[1] The narrative can be

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* Professor of Law, Co-Director, Illinois Program in Business Law and Policy, University of Illinois College of Law. The author would like to thank participants at the Michigan State University College of Law conference on business law and narrative and Jayne Barnard for her live blogging of the Madoff allocution for Conglomerate blog: The Conglomerate, http://www.theconglomerate.org (last visited May 12, 2010).

1. Narrative is also important in the lawmaking realm, with those arguing for or against regulation arming themselves with narratives, a fancier word for anecdotes. *See generally* David A. Hyman, *Lies, Damned Lies, and Narrative*, 73 IND. L.J. 797, 804-07

as important as the facts or the law and will weave both facts and law together into a familiar story that resonates with the particular audience. In white-collar crime, some narratives are hard to devise because the facts are complicated.[2] Prosecutors prefer simple frauds over complex ones, and may often choose which behavior to prosecute based on how well the jury will understand the narrative they will be able to construct.[3] Unfortunately for Bernard Madoff, the crime with which he was charged was simple and familiar, a centuries-old scam any juror would recognize.[4] In addition, Ma-

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(1998) (giving many examples of legislative efforts that were fueled by "unrepresentative" and "questionable" narratives, including welfare reform, tort reform, and environmental protection). Professor Hyman's article also contains a helpful listing of many important scholarly works on the intersection of law and narrative. *Id.* at 798 nn.4-7.

2. One strategy is to try to boil down a complicated financial fraud to one false statement, as the prosecution tried unsuccessfully to do in the trial of two Bear Stearns hedge fund managers. *See* Zachery Kouwe & Dan Slater, *2 Bear Stearns Fund Leaders Are Acquitted*, N.Y. TIMES, Nov. 11, 2009, at A1 (reporting that the defense attorney warned the jury that the prosecution was taking email comments out of context as "'misleading sound bites'"); Thom Weidlich & Carlyn Kolker, *Bear Stearns Loss Echoes Long Line of U.S. Prosecution Defeats*, BLOOMBERG.COM, Nov. 12, 2009, http://www.bloomberg.com/apps/news?pid=20670001&sid=apkJQ71ZFjJs (noting that the common prosecutor strategy of isolating a few emails to depict a complex fraud story had backfired in both the Bear Stearns trial and the Frank Quattrone trials). *See also* Lawrence Delevingne, *What the Bear Stearns Acquittal Means for Wall Street*, BUS. INSIDER, Nov. 14, 2009, http://www.businessinsider.com/ what-the-bear-stearns-acquittal-means-for-wall-street-2009-11 (reporting that "[s]ources close to the prosecution" believed that "the Brooklyn jury wasn't sophisticated enough to understand" the complex fraud, but quoting a prominent attorney as saying "I don't know a losing trial lawyer who thinks the jury got it").

3. *See* Christine Hurt, *The Undercivilization of Corporation Law*, 33 J. CORP. L. 361, 395 (2008) (explaining that given the complexity of the financial transactions at the heart of the investigation of Enron Corp., prosecutors chose "the simplest cases to bring criminal charges against Enron and [its officers]").

4. *See* Noel Sheppard, *The Social Security Ponzi Scheme*, AM. THINKER, Mar. 16, 2005, http://www.americanthinker.com/printpage/?url=http://www.americanthinker.com/2005/03/the_social_security_ponzi_sche.html ("'Ponzi schemes are a type of illegal pyramid scheme named for Charles Ponzi . . . . Decades later, the Ponzi scheme continues to work on the "rob-Peter-to-pay-Paul" principle, as money from new investors is used to pay off earlier investors until the whole scheme collapses.'" (citation omitted)); BLACK'S LAW DICTIONARY 1278 (9th ed. 2009) (defining "Ponzi scheme" as "[a] fraudulent investment scheme in which money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments. Money from the new investors is used directly to repay or pay interest to earlier investors, usu. without any operation or revenue-producing activity other than the continual raising of new funds."). Note that although Ponzi schemes are necessarily pyramid schemes, many "pyramid schemes," where salespeople recruit other salespeople and receive a percentage of the sales of those they recruit, are legitimate multi-level marketing businesses that sell actual products or services. *See generally* Sergio Pareja, *Sales Gone Wild: Will the FTC's Business Opportunity Rule Put an End to Pyramid Marketing Schemes?*, 39 MCGEORGE L. REV. 83 (2008) (discussing differences in illegal and legal multi-level marketing businesses). However, some fraudulent pyramid schemes exist solely to collect initial investment money from new recruits without actually selling a product or service. *See* BLACK'S LAW DICTIONARY

doff had no compelling counter-narrative[5] to mitigate the unsympathetic depiction of himself as an unfeeling scoundrel who stole from his closest friends and relatives. Perhaps for these and other reasons, Madoff chose to forego a trial and plead guilty.[6]

However, the audience was not finished judging Madoff. Although he escaped a trial, he was judged quite harshly in the court of public opinion. Madoff's financial crimes, which resulted in many individuals, businesses, and charitable foundations losing great amounts of money, became a symbol for the greediness and immorality of a financial meltdown he did not cause. Numerous newspaper and magazine articles[7] and even books[8] were quickly written about Madoff, and the audience's hatred for him was clear. Madoff was eventually sentenced to 150 years in prison,[9] an amazingly long prison term for a seventy-one-year-old man who had pled guilty quickly and saved the government the burden of a trial.[10] In his sentencing remarks, Judge Denny Chin rejected the notion that Madoff's fraudulent investment scheme was a "bloodless . . . crime" and instead described it as an "extraordinary evil."[11]

1357 (9th ed. 2009) (defining "pyramid scheme" as "[a] property-distribution scheme in which a participant pays for the chance to receive compensation for introducing new persons to the scheme, as well as for when those new persons themselves introduce participants").

5. Transcript of Sentencing Hearing at 46-49, United States v. Madoff, 626 F. Supp. 2d 420 (S.D.N.Y. June 29, 2009) (No. 09 Cr. 213), *available at* http://www.justice.gov/usao/nys/madoff/20090629sentencingtranscriptcorrected.pdf [hereinafter Sentencing Transcript] ("In terms of mitigating factors in a white-collar fraud case such as this, I would expect to see letters from family and friends and colleagues. But not a single letter has been submitted attesting to Mr. Madoff's good deeds or good character or civic or charitable activities. The absence of such support is telling.").

6. *See* Transcript of Plea Hearing at 25, United States v. Madoff, 626 F. Supp. 2d 420 (S.D.N.Y. June 29, 2009) (No. 09 Cr. 213), *available at* http://www.justice.gov/usao/nys/madoff/madoffhearing031209.pdf [hereinafter Plea Transcript].

7. The most in-depth magazine coverage came from *Vanity Fair*, under the category of "The Madoff Chronicles," which ran from January 2009 to September 2009. *See, e.g.*, Mark Seal, *Madoff's World*, VANITY FAIR, Apr. 2009, at 124 ("Amid the sobs, screams, and curses in Aspen, Palm Beach, and New York, with victims sharing their stories, [the author] gets behind Madoff's affable façade, to reveal his most intimate betrayals.").

8. *See, e.g.*, HARRY MARKOPOLOS, NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER (2010); ERIN ARVEDLUND, TOO GOOD TO BE TRUE: THE RISE AND FALL OF BERNIE MADOFF (2009); ANDREW KIRTZMAN, BETRAYAL: THE LIFE AND LIES OF BERNIE MADOFF (2009); SHERYL WEINSTEIN, MADOFF'S OTHER SECRET: LOVE, MONEY, BERNIE, AND ME (2009).

9. *See* Janet Morrissey, *The Penalty for "Extraordinary Evil": Madoff Gets 150 Years*, TIME, June 29, 2009, http://www.time.com/time/business/article/0,8599,1907677,00.html.

10. *But see id.* (noting that the previous year, a 72-year-old fraudster was sentenced to 330 years).

11. *See* Sentencing Transcript, *supra* note 5, at 47-49.

Though Madoff himself has been largely silent, his victims have created their own Bernie Madoff narrative out of their stories. These stories have been told online,[12] in the press,[13] in victim impact statements, and in congressional testimony.[14] These narratives have worked within legal structures to shape Madoff's sentence,[15] to rewrite laws to reform the victims' financial compensation,[16] and possibly to increase regulation of hedge funds,[17] though Madoff was only *pretending* to be a hedge fund.[18]

This Article will examine the Madoff scandal and attempt to place it within the realm of modern financial frauds and the sensationalism surrounding them. Particularly, this Article will hypothesize that in the relatively safe and healthy environment of twenty-first-century United States, perceived threats to financial welfare are more salient to most Americans

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12. Several websites are dedicated to the support of and airing of grievances by Madoff victims. *See, e.g.*, Bernard Madoff Victims Coalition, Bernard Madoff Fraud Victims Support Group Website, http://bernardmadoffvictims.org/ (last visited May 12, 2010); Madoff Help, News & Assistance Website & Blog, http://www.madoff-help.com/ (last visited May 12, 2010); Newsvine, http://madoffvictim.newsvine.com/ (last visited May 12, 2010).

13. *See, e.g.*, Robert Chew, *How I Got Screwed by Bernie Madoff*, TIME, Dec. 15, 2008, *available at* http://www.time.com/time/business/article/0,8599,1866398,00.html ("We didn't know it yet, but we had been playing in the Bernard Madoff Investment Securities LLC Fantasy Financial League.").

14. On December 9, 2008, Madoff victims were invited to speak before a subcommittee of the House of Representatives Financial Services Committee. *See, e.g.*, *Additional Reforms to the Securities Investor Protection Act: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 111th Cong. (2009) (statement of Helen Davis Chaitman, Madoff Investor and Legal Advisor to the Madoff Coalition for Investor Protection), *available at* 2009 WL 4647556 [hereinafter Chaitman Testimony].

15. *See* Sentencing Transcript, *supra* note 5, at 42 ("I take into account what I have read in the presentence report, the parties' sentencing submissions, and the e-mails and letters from victims. I take into account what I have heard [from testifying victims] today.").

16. *See* John D. McKinnon & Jane J. Kim, *Ponzi Scheme Victims Get a Tax Break*, WALL ST. J., Mar. 18, 2009, at A4 (reporting that the Internal Revenue Service issued two new regulations giving the Madoff victims and other Ponzi scheme victims "unprecedented tax relief" in response to pressure from the victims). In addition, legislation has been introduced to change victim compensation awarded by the Securities Investor Protection Corporation. *See, e.g.*, H.R. 2798, 111th Cong. (1st Sess. 2009) (proposing to increase SIPC coverage of investors who are the victims of fraud).

17. *See* Hedge Fund Adviser Registration Act of 2009, H.R. 711, 111th Cong. (1st Sess. 2009) (abolishing the registration exemption for hedge fund managers with fifteen or fewer clients).

18. Madoff never referred to his advisory fund as a hedge fund, but others did. *See* ARVEDLUND, *supra* note 8, at 151 ("Madoff never called his off-the-books side business a hedge fund. He never even gave it a name. He swore investors to secrecy, making them promise not to tell anyone he was managing their money."). Note that Madoff operated for years without registering as an investment advisor, without relying on the fifteen-or-fewer exemption because he had many more than fifteen clients. *Id.*

than perceived threats to our physical welfare.[19] Because of this reversal, the harsh sentencing of financial fraudsters compared to that of violent criminals reflects the values of a modern society. To those whose greatest fear is to outlive their retirement funds, Madoff's fraudulent investment scheme is an "extraordinary evil." Therefore, the Madoff victim narrative resonates with judges, lawmakers, and the public at large.

I. MADOFF'S EXTRAORDINARY CRIME

A. The Rise and Fall of Bernard L. Madoff Investment Securities

Bernard L. Madoff founded his firm, Bernard L. Madoff Investment Securities (BLMIS), in 1960.[20] Madoff was young and barely out of college[21] when he founded his operation with money borrowed from his father-in-law.[22] Though the firm was known for decades as a trading and market-making firm, Madoff had been running a secret investment advisory business since the inception of BLMIS.[23] Because Madoff was not a registered investment advisor until 2006,[24] this business was always illegal,[25] but was well known as a hedge fund by the late 1990s, although it probably never operated as an investment fund at all. This fund operated two floors below Madoff's legitimate operations, staffed leanly by its chief financial officer, Frank DiPascali, who held only a high school degree,[26] and Annette Bon-

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19. *See infra* Part IV.

20. Seal, *supra* note 7, at 124.

21. After graduating from Hofstra University, Madoff went to Brooklyn Law School for one year before dropping out. *See* ARVEDLUND, *supra* note 8, at 20. However, he fostered the idea among his clientele that he was an attorney. *See id.* (noting that his website used the language that he started BLMIS "'in 1960 soon after leaving law school'").

22. *See* KIRTZMAN, *supra* note 8, at 37 (noting that he started his fund at the age of twenty-two, after passing the General Securities Representative exam and the General Securities Principal exam).

23. *See* ARVEDLUND, *supra* note 8, at 30.

24. Madoff confessed in his plea allocution that he had lied on his 2006 investment adviser registration. *See* Plea Transcript, *supra* note 6, at 28 ("On this form I intentionally and falsely certified under penalty of perjury that Bernard L. Madoff Investment Securities had custody of my advisory clients' securities. That was not true, and I knew it . . . .").

25. *See id.* at 54 ("Madoff wasn't registered as an investment adviser, so his advisory business was always illegal." And it may have always been an outright fraud.).

26. Frank DiPascali began working for Madoff in 1975 after graduating from high school, working his way up to supervising the 17th floor by 1987. Plea Hearing Transcript at 44-45, United States v. DiPascali, No. 09 Cr. 764 (S.D.N.Y. Aug. 11, 2009), *available at* http://www.justice.gov/usao/nys/madoff/dipascaliplea81109.pdf [hereinafter DiPascali Plea Transcript]. DiPascali believes that the fraud began in the late 1980s or early 1990s. *See id.* at 46 ("I represented to hundreds, if not thousands, of clients that security trades were being placed in their accounts when in fact no trades were taking place at all.").

giorno, who supervised a team of young workers with no finance training.[27] According to investigators, though monthly statements to investors showed profitable investment activity, no trades had been effected by the fund in its last thirteen years of operation.[28] In addition to the U.S. operations, Madoff also owned Madoff Securities International Limited, based in London,[29] which went bankrupt at the same time as BLMIS.

By December 2008, the advisory business part of BLMIS serviced almost 5,000 client accounts and showed client funds of almost $65 billion on its financial statements.[30] However, the money did not exist, and in fact BLMIS accounts held only a tiny fraction of that amount, only funds that had recently been received and not moved to other accounts controlled by Madoff.[31] Total client losses have been estimated at between $13.2 billion[32] and $65 billion, depending on the method of calculation.[33] Regulators have estimated that over the life of the fund, Madoff probably received no more than $20 billion in client funds; because that money was never invested, the phantom billions never existed.[34]

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27. *See* Mark Seal & Eleanor Squillari, *"Hello Madoff!" The Madoff Chronicles, Part II: What the Secretary Saw*, VANITY FAIR, June 2009, at 160-61 (describing the atmosphere of the 17th floor, which was kept separate from the trading operations of the 19th floor).

28. Tom Hays, *Madoff Ponzi Scheme: No Indication Stocks Were Ever Purchased*, HUFFINGTON POST, Feb. 20, 2009, *available at* http://www.huffingtonpost.com/2009/02/20/madoff-ponzi-scheme-stock_n_168568.html.

29. *See* KIRTZMAN, *supra* note 8, at 176.

30. Government's Sentencing Memorandum at 3, United States v. Madoff, 626 F. Supp. 2d 420 (S.D.N.Y. June 26, 2009) (No. 09 Cr. 213) [hereinafter Sentencing Memorandum].

31. *See* ARVEDLUND, *supra* note 8, at 192 (reporting that between September 2008 and December 11, 2008, Madoff's sole business bank account, at JP Morgan Chase, came close to zero several times, after averaging a balance of several billions in past years).

32. *See* Sentencing Memorandum, *supra* note 30, at 7.

33. The calculation of investor losses, particularly those losses that are covered by the Securities Investor Protection Corporation insurance, is the subject of ongoing litigation. Generally, there is a dispute as to whether "losses" are the difference between what clients invested and what they withdrew over time or the amount that clients believed they had invested according to their monthly statements. In addition, other issues such as taxes paid on phantom gains and mandatory withdrawals pursuant to IRA accounts further complicate how to calculate individual losses. *See generally* Memorandum of Law in Support of Victims' Motion for Reconsideration, United States v. Madoff, 626 F. Supp. 2d 420 (S.D.N.Y. June 26, 2009) (No. 09 Cr. 213) (disagreeing with SIPC trustee Irving Picard's calculation of valid customer claims).

34. Some have estimated that the most that Madoff ever received from investors was $20 billion, making a frantic search for the missing $65 billion illusory. *See* James Bandler, Nicholas Varchaver & Doris Burke, *How Bernie Did It*, FORTUNE, May 11, 2009, at 51, 70-71 (noting that investigators are not going to have a "miraculous discovery of a giant vault with $65 billion in cash" because the actual amount received, and spent, over the years was approximately $20 billion).

Meanwhile, the trading arm of BLMIS was highly successful[35] and brought to Madoff a sterling business reputation, which surely helped recruit advisory clients. In addition, Madoff's efforts in the 1970s and 1980s to establish competitive regional exchanges and to increase the influence of the NASDAQ[36] brought him the respect and trust of the SEC, which had a similar agenda to break the trading monopolies of the NYSE and the AMEX.[37] However, Madoff's strategy for trading success—luring trades off of the NYSE and creating a "third market"—established him forever as a type of maverick outsider, a reputation that may have also helped him gain investors who did not trust traditional Wall Street financial types.[38]

Exactly when Madoff changed course from operating a legitimate, but illegal, investment fund for his clients to operating one of the largest Ponzi schemes in history is unclear.[39] Madoff maintains that he was investing

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35. *See* ARVEDLUND, *supra* note 8, at 37 (noting that by 1986, "*Financial World* listed Madoff as one of the top one hundred best paid on Wall Street").

36. Madoff often referred to himself as a founder or a designer of the NASDAQ, which was untrue. *See* Bandler et al., *supra* note 34, at 59, 62 (quoting Charles "Dick" Justice, former chief technology officer of the National Association of Securities Dealers as saying that Madoff was neither a founder nor a designer of the NASDAQ). However, he did use the electronic trading platform to his advantage and headed the NASDAQ design committee from 1981 to 1983. *See* ARVEDLUND, *supra* note 8, at 33-34.

37. *See* ARVEDLUND, *supra* note 8, at 39.

38. Madoff's firm was one of the first to lure trades off of the NYSE by offering brokers a one-cent rebate. During this time, market makers made money on each trade by "the spread" between the buyers and the sellers, in increments of one-eighth of a dollar, or 12 ½ cents. By increasing traffic, the one-cent rebate was a small price to pay for trades. However, this practice did not make Madoff any fans at the NYSE, including Richard Grosso. The paying for trade flow practice eventually came under scrutiny by the SEC, but the practice was never prohibited. *Compare* Richard L. Stern, *Living Off the Spread*, FORBES, July 10, 1989, at 66 (presenting Madoff's rebates as good for both brokers and customers), *with* Gary Slutsker, *If You Can't Beat 'Em*, FORBES, Jan. 6, 1992, at 48 ("Intelligent people can disagree as to whether . . . [Madoff's rebate] is good or bad for investors."), *and* Neil Weinberg & Daniel Kruger, *Death by a Thousand Trades*, FORBES, Dec. 11, 2000, at 262, 264 ("Payment for order flow is, alas, but one of several ways Wall Street profits from the unwary."). In fact, Madoff gained more friends at the SEC during the investigation. *See* Bandler et al., *supra* note 34, at 62 (quoting a former SEC chairman and head of the investigating panel as saying "we got pretty chummy").

39. During Madoff's allocution, he was vague about when the fraudulent operations began. The closest that Madoff came to naming a date was when he stated that "[t]o the best of my recollection [the scheme] began in the early 1990s" due to the recessionary investment climate. *See* Plea Transcript, *supra* note 6, at 25 ("While I never promised a specific rate of return to my client, I felt compelled to satisfy my clients' expectations, at any cost."). However, the prosecution stated at the same hearing that the government would have proved at trial that Madoff had operated a Ponzi scheme since "at least as early as the 1980s." *Id.* at 31-32.

client funds until sometime in the 1990s, when the market was struggling.[40] Others guess that the fund was never legitimate and that returns were funded by the once extremely lucrative market-making business. However, as market-making profits were thinned due to the decimalization of stock prices, eliminating large spreads between the bid and ask prices,[41] these profits may not have been enough to cover returns, requiring Madoff to repay early investors with new investors' money. In the 1990s, Madoff definitely made a push for more and more investors through recruiters, maintaining the sense of exclusivity necessary to lure in investors.[42] Regardless of whether the fund was ever truly an investment fund, Madoff admits that for the past many years, it was nothing other than a Ponzi scheme,[43] even though the fund had survived several close calls with regulators[44] and curious competitors.[45] One remaining question is whether the illegitimate in-

40. *See* ARVEDLUND, *supra* note 8 (noting that some argued that the fund turned fraudulent during the crash of 1987, but that at least by 1993, Madoff was actively recruiting investors to his fund).

41. Madoff's market-making goose was hit hard when the spread between bid and ask prices for stocks in the United States was cut first to one-sixteenth of a dollar, or six and one-quarter cents, in 1997, and then to one cent in 2001. *See* Bandler et al., *supra* note 34, at 64 (reporting that "Madoff's market-making operation would never again be the prodigious cash generator it had been"). Market-making profits at BLMIS fell half a billion dollars between 2000 and 2005, leading both Charles Schwab and Goldman Sachs to offer to buy the market-making arm of BLMIS. *See* ARVEDLUND, *supra* note 8, at 170-72 (noting that during this time, the 17th floor operations probably began to subsidize the 19th floor operations).

42. Madoff used a network of recruiters and feeder funds to bring in clients, including Robert Jaffe in Palm Beach, Mike Engler in Minnesota, Walter Noel in Connecticut, Ezra Merkin in Manhattan, Sonja Kohn in Austria, and Thierry de la Villehuchet in France. *See* Seal & Squillari, *supra* note 27, at 162.

43. *See* Plea Transcript, *supra* note 6, at 23 ("Your Honor, for many years up until my arrest on December 11, 2008, I operated a Ponzi scheme through the investment advisory side of my business, Bernard L. Madoff Securities LLC . . . .").

44. Madoff came very close to being discovered at least three times. In 1992, a skeptical client of Madoff's first "feeders," Frank Avellino and Michael Bienes, tipped off the SEC to the two recruiters, who guaranteed investors returns of twenty percent. Madoff stepped in and named himself their broker and "returned" all the client monies, approximately $440 million, claiming he thought they were registered investment advisors. *See* KIRTZMAN, *supra* note 8, at 64. Satisfied Avellino and Bienes customers then became direct Madoff clients, and the SEC thought that Madoff was the good guy. *Id.* at 64-65. Again, in 2005, after an SEC investigation, which involved one SEC attorney who later married Madoff's niece Shana, the SEC cited Madoff for three minor violations. *See* ARVEDLUND, *supra* note 8; KIRTZMAN, *supra* note 8. In November 2007, thirteen months before Madoff would confess to one of the largest frauds in U.S. history, the SEC closed another investigation of BLMIS by saying that the staff had found no evidence of fraud. *See* ARVEDLUND, *supra* note 8; KIRTZMAN, *supra* note 8.

45. Harry Markopolos, a "rocket scientist" who offered investment clients complex trading programs, is now widely credited with being the first person to see through Madoff's mystique. However, because of his eccentric personality, personal bias against his competitor, and perceived reward motivation, the SEC dismissed his concerns repeatedly beginning in 1999. *See The Man Who Figured Out Madoff's Scheme*, CBS NEWS, Mar. 1, 2009,

vestment operations infected the otherwise successful market-making operations, which employed Madoff's sons Mark and Andrew Madoff.[46]

What is known is that the bleak economic climate of recent years[47] hastened the inevitable collapse of BLMIS in the fall of 2008.[48] Clients otherwise satisfied to let huge sums of money be reinvested from year-to-year with BLMIS[49] suddenly wanted or needed to redeem these sums by the end of 2008. Madoff was faced with claims for redemptions of $7 billion from accounts that did not exist,[50] and he had no conceivable way to raise that kind of capital. On December 9, 2008, Bernie Madoff told his two sons that his empire was a sham, a Ponzi scheme.[51] He explained that he was going to pay out bonuses early to employees, friends, and family before turning himself into federal authorities. In fact, Madoff wrote $173 million

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http://www.cbsnews.com/stories/2009/02/27/60minutes/main4833667.shtml; Erin E. Arvedlund, *Don't Ask, Don't Tell: Bernie Madoff Is So Secretive, He Even Asks His Investors to Keep Mum*, BARRON'S, May 7, 2001, at 26 (questioning Madoff's consistently high returns and his response of "'It's a proprietary strategy. I can't go into it in great detail.'"); Michael Ocrant, *Madoff Tops Charts; Skeptics Ask How*, MARHEDGE, May 2001, at 1 (reporting that experts stated that Madoff's stated "split-strike conversion strategy" has never been employed successfully by others).

46. In its early years, the fund may have operated as a source of capital for the trading arm, generating returns from that business that were given back to investors.

47. According to prosecutors, BLMIS also suffered a "liquidity crisis" beginning in November 2005, which caused BLMIS to secure a bank letter of credit, collateralized by $154 million worth of bonds forwarded by a client for deposit. BLMIS used these borrowed funds to meet withdrawal requests until able to repay the bank with new investment funds in April 2006. The client who owned the bonds was never notified of the loan. *See* Complaint, United States v. Bonventre, 10 Mag. 385 (S.D.N.Y. Feb. 24, 2010), *available at* http://www.justice.gov/vsad/nys/madoff/bonventrecomplaint.pdf [hereinafter Bonventre Complaint].

48. *See* ARVEDLUND, *supra* note 8, at 165 ("Madoff's fraudulent hedge fund might have continued had the stock markets not collapsed around the world. But with the crashing economy, all of a sudden all his investors wanted their money back—and they wanted it now. The stock market collapse of 2008 squeezed his investors all at the same time—and they came running to him for money."). In addition, the worsening financial environment made financial experts increasingly skeptical of Madoff's eternally positive returns. Not only was it inconceivable that in the fall of 2008 his funds were up 4.5% when the market was down 30%, but his options trading strategy story depended on a liquidity in the market that just was not there. *See* KIRTZMAN, *supra* note 8, at 218 (quoting a feeder fund manager as asking a co-worker: "'How do the counterparties at the banks provide enough liquidity to allow the options to be put on?' . . . 'My understanding is dealing desks are currently doing almost everything on an order or best efforts basis—and not providing risk capital to anyone.'").

49. *See* ARVEDLUND, *supra* note 8, at 264 (referring to the accounts that stayed invested over generations with Madoff as the "sticky money" and noting that in fall 2008, those clients wanted their money out).

50. *See id.*

51. *See* David Margolick, *The Madoff Chronicles, Part III: Did the Sons Know?*, VANITY FAIR, July 2009, at 66, 72.

in checks that day but did not send them.[52] His sons immediately repeated this story, first to an attorney, then to the FBI and the U.S. Attorney's office.[53] The next day, Bernie Madoff was arrested in his apartment after being confronted by the FBI. He would eventually be charged with eleven criminal counts;[54] Madoff would plead guilty to all eleven.[55]

At the time of this writing, Madoff's insistence that his scheme was a solitary venture has shaped the ongoing investigation.[56] Though private lawsuits and the bankruptcy court have targeted family members and feeder funds for compensation and restitution, criminal prosecutions have thus far focused on a narrow group of insiders. As of July 2010, federal authorities have prosecuted only Madoff's accountant, David G. Friehling,[57] DiPascali,[58] another BLMIS director of operations, Daniel Bonventre,[59] and two

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52. *See* Seal & Squillari, *supra* note 27, at 162-63 (reporting that Madoff's secretary believes that the signing of those checks was part of some strategy Madoff was employing because he never signed checks and checks were never left overnight).

53. *See* Margolick, *supra* note 51, at 72-73 (reporting that the sons first went to see Mark's father-in-law, who then contacted his fellow Paul Weiss partner, Martin Flumenbaum, who arranged for the two to meet with DOJ and SEC officials the next morning).

54. The charges were "securities fraud, investment adviser fraud, mail fraud, wire fraud, two counts of international money laundering, money laundering, false statements, perjury, false filing with the SEC, and theft from an employee benefit plan. *See* Sentencing Memorandum, *supra* note 30, at 3-4.

55. *See* Plea Transcript, *supra* note 6, at 4, 23.

56. Madoff insists that neither his employees nor his family knew of his scheme. *See* Sentencing Transcript, *supra* note 5, at 36 ("How do you excuse deceiving 200 employees who have spent most of their working life working for me? How do you excuse lying to your brother and two sons who spent their whole adult life helping to build a successful and respectful business? How do you excuse lying and deceiving a wife who stood by you for 50 years, and still stands by you?").

57. One accountant, David G. Friehling, entered into a prosecution agreement on Nov. 3, 2009, whereby he pleaded guilty to nine counts of securities fraud, investor adviser fraud, and tax fraud that could result in a total maximum sentence of 114 years imprisonment. *See* Letter from Preet Bharara, U.S. Attorney, Southern District of New York, to Andrew Lankler, Esq., Attorney for David G. Friehling (Nov. 3, 2009), *available at* http://www.justice.gov/usao/nys/madoff/friehlingdavidpleaagreement.pdf. Though Friehling maintains that he did not know that Madoff was running a fraudulent scheme and that his family members were investors in BLMIS, he has agreed to forfeit $3.1 million and plead guilty. *See* Diana B. Henriques, *Plea from Madoff Accountant May Lead to Tax Cases*, N.Y. TIMES, Nov. 4, 2009, at B2. Friehling's partner, his own father-in-law, Jerome Horowitz, who had formerly handled the Madoff account, died from cancer on March 12, 2009, the day that Madoff pleaded guilty. *See id.*

58. Frank DiPascali waived indictment and pleaded guilty on August 11, 2009, to ten counts of conspiracy, securities fraud, investment advisory fraud, falsifying books and records, wire fraud, mail fraud, perjury, and income tax evasion for a possible maximum term of imprisonment of 125 years and is awaiting sentencing. *See* DiPascali Plea Transcript, *supra* note 26, at 18-20, 32, 44 ("I am standing here today to say that from the early 1990s until December of 2008 I helped Bernie Madoff, and other people, carry out the fraud that hurt thousands of people."). In his plea agreement, DiPascali agreed to give substantial

computer programmers,[60] with helping Madoff perpetrate the fraud. The SEC charged two feeder funds in civil proceedings, though the court seems skeptical of aiding and abetting allegations against them.[61]

B. Madoff's Scheme as Affinity Fraud

Madoff's fraudulent financial scheme was a particular type of scheme known as an "affinity fraud." In this type of fraud, confidence men (or women) gain the trust of people within their own community, whether it's a neighborhood, club, or religious organization.[62] Affinity frauds are common frauds because the scheme is facilitated by the implicit trust and decreased skepticism of the community, coupled with familiarity of known investors.[63] Madoff initially recruited clients in the 1960s from the circle of mostly Jewish friends and acquaintances of his accountant father-in-law. As Madoff's reputation grew, his stable of clients grew from wealthy Jewish families on Manhattan's Upper East Side to Palm Beach, Florida, to Aspen, Colorado. Foundations begun by Steven Spielberg (the Wunderkind Foundation) and Elie Wiesel (Foundation for Humanity) were clients, as was Yeshiva Uni-

assistance and cooperation to the government, but was not granted bail, over prosecutors' objections. *See id.* at 40-41.

59. Bonventre was charged with eight criminal counts, including securities fraud, making false filings with the SEC, making false books and records of a broker-dealer, and tax fraud. *See* Bonventre Complaint, *supra* note 47, at 4-8. *See also* Diane B. Henriques, *Another Madoff Aide Faces Fraud Charges*, N.Y. TIMES, Feb. 26, 2010, at B1 (reporting that Bonventre's attorney claimed his client, a thirty-year BLMIS employee, is "absolutely innocent").

60. *See* Complaint at 1-7, United States v. O'Hara, 09 Mag. 2484 (S.D.N.Y. Nov. 12, 2009), *available at* http://www.justice.gov/usao/nys/madoff/oharaperezcomplaint.pdf (charging the two defendants with one count of conspiracy to falsify books and records of a broker-dealer and of an investment adviser, one count of falsifying books and records of a broker-dealer, and one count of falsifying books and records of an investment adviser).

61. A federal district court in New York dismissed the majority of fraud claims brought against Cohmad Securities Corporation, its principals, and recruiter Robert Jaffe. SEC v. Cohmad Sec. Corp., No. 09 Civ. 5680, 2010 WL 363844, at *2 (S.D.N.Y. Feb. 2, 2010) (holding that "the complaint supports the reasonable inference that Madoff fooled the defendants as he did the individual investors, financial institutions, and regulators"). Stanley Chais, a feeder based in California, has also been charged by the SEC. Complaint, SEC v. Chais, 09 Civ. 5681 (S.D.N.Y. June 22, 2009), *available at* http://www.sec.gov/litigation/complaints/2009/comp.21096.pdf.

62. *See* Lisa M. Fairfax, *The Thin Line Between Love and Hate: Why Affinity-Based Securities and Investment Fraud Constitutes a Hate Crime*, 36 U.C. DAVIS L. REV. 1073, 1074 (2003) (defining "affinity fraud" as "securities and investment fraud that targets identifiable racial, ethnic, or religious groups perpetrated by members of the group or people claiming to want to assist members of the group").

63. *See* Deborah Sontag, *Immigrants Swindle Their Own, Preying on Trust: Race, Religion and Ethnic Background Give Con Artists an Inside Track to Victims*, N.Y. TIMES, Aug. 25, 1992, at B1 (describing seven affinity frauds investigated by the SEC between 1987 and 1992 that targeted immigrants from India, Poland, El Salvador, China, and Vietnam).

versity and Hadassah, the Women's Zionist Organization of America. Each of his clients, even his closest friends and relatives, were victims; none had actual client accounts and none of their investments were immune from the fraud. Madoff rendered penniless the heirs of his mentor, Norman F. Levy, his best friend Carl Shapiro, retirees he met at the Palm Beach Country Club, and even a widow he convinced to invest in the scheme during its last weeks. Because of his "largely Jewish clientele," comparisons to Hitler have been frequent;[64] however, unlike Hitler, Madoff bilked not faceless stranger–victims, but friends and friends of friends that he looked in the eye and to whom he owed a fiduciary duty as a financial advisor.

In arguing for the maximum sentence of 150 years, the prosecution focused on the particular evils of affinity fraud: "Moreover, Madoff's crimes were personal, to the account holders (both small and large) to whom he owed a fiduciary duty, and with many of whom he and his firm had a personal relationship over the course of years."[65] In addition, the prosecution noted several times that some of the victims were foundations and charitable institutions.[66]

Affinity fraud causes the same economic harm as any financial fraud, but the social harm may be even greater. Victims feel doubly wronged because they were betrayed by someone they had felt a bond with, someone they honored with their trust.[67] Especially if the group has historically been the target of discrimination, the victims may feel particular shame and a sense of harm, which the perpetrator, as a member of the community, knows and appreciates.[68] In fact, the perpetrator may be able to gain the trust and confidence of his fellow community members by preying on a sense that others outside the group would not have their best interests at heart and

64. This comparison is probably not just an example of *reductio ad Hitlerum* or Godwin's Law that as an argument increases in length the probability that someone will analogize to Hitler or the Nazis increases. In this case, speakers are attempting to make a not-inapposite comparison of someone who did great harm to the Jewish people, albeit financial harm.

65. *See* Sentencing Memorandum, *supra* note 30, at 9.

66. *Id.* ("'The main tragedy for our family and our community is the loss of our Family Foundation. With over five million dollars invested with Madoff, the entire Principal of the Foundation, we are no longer able to support the various organizations which depended on us. These include Food Banks, Homeless Shelters, Homes for the aged, Various Jewish Organizations and a wonderful program for teaching outdoor winter sports to the disabled including all disabilities and more recently for disabled veterans.'" (quoting one victim impact statement)).

67. *See* Fairfax, *supra* note 62, at 1127-28 ("The law recognizes that crimes violating trust or trust relationships generate greater harm than crimes that do not involve trust.").

68. *See id.* at 1140 (arguing that perpetrators in the same target class understand the prejudicial biases that are directed at the class, use them to their advantage, and recognize that the harm caused will be enhanced because of those biases).

would take advantage of the investor–victims.[69] Even members of the group who were not victims of the fraud may feel negative effects.[70] He probably victimized his fellow members of the Jewish faith not out of animus toward the faith but out of opportunism.[71] Nevertheless, members of the Jewish community felt the ripple effects of the fraud and feared that public reaction to Madoff's crime would result in enhanced anti-Semitism and further negative stereotyping of Jewish participants in the financial markets.[72]

Madoff certainly used his social network to bring in new clients, creating an aura of exclusivity even while heavily marketing to his own through recruiters.[73] He turned down many wealthy clients, perhaps choosing those investors who were the least financially savvy, the least inquisitive, and the least demanding.[74]

II. VICTIMS SHAPE THE MADOFF NARRATIVE

The response to the revelation of Madoff's decades-long fraud was understandably hostile, both from victims and from the broader public. Unfortunately, but not unrelated, the discovery of Madoff's crimes in December 2008 came on the heels of one of the largest economic downturns in U.S. financial history.[75] The 2008 year began with a 300-point drop in the Dow index on January 17. The real crash would happen later, with the Dow plunging 504 points on September 16. During the next few days, the exiting Bush administration would "bail out" AIG for $85 billion, but not Lehman

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69. *See* Sontag, *supra* note 63, at B1 (reporting that one affinity fraud victim told investigators that the fraudster, also an Indian immigrant, had explained to him the "greed" and "fear" at work in Wall Street, making him trust that the fraudster had his interests in mind).

70. *See* Fairfax, *supra* note 62, at 1130-33 (explaining some of the negative social effects of affinity fraud, such as reluctance to invest and network in the future and stigmatization as gullible and unintelligent).

71. *See id.* at 1138 (analyzing whether affinity crimes should be treated as hate crimes based on whether the perpetrator acted out of animus to the group or out of opportunism).

72. *See* Sentencing Transcript, *supra* note 5, at 19-20 ("A righteous Jew, when in reality nobody has done more to reinforce the ugly stereotype that all we care about is money the fact is there are no people on this earth more charitable?") (statement of investor–victim).

73. *See* Complaint at 10, SEC v. Cohmad Sec. Corp., No. 09 Civ. 5680 (S.D.N.Y. Feb. 2, 2010) (describing how Madoff "representatives" like Robert Jaffe "offhandedly mentioned that they were affiliated with Madoff" and might "agree to put in a good word with Madoff" as a "clever marketing strategy").

74. *See id.* at 18 (alleging that Madoff told feeders not to solicit sophisticated investors or those with a finance or banking background).

75. As Warren Buffett once remarked, "After all, you only find out who is swimming naked when the tide goes out." Letter from Warren Buffett, Chairman, Berkshire Hathaway, Inc., to Shareholders, Berkshire Hathaway, Inc. (Feb. 28, 2002), *available at* http://www.berkshirehathaway.com2001ar/2001letter.html.

Brothers, who would declare bankruptcy. On September 19, President Bush announced a $700 billion plan to save the financial industry and the U.S. economy. On September 29, the House of Representatives voted not to approve the plan, and the Dow plunged another 777 points. Congress eventually passed the "bailout bill" the following week, but the economic crisis would continue for months. As individuals watched their 401(k) values plummet and their house values diminish, panic set in. Madoff victims, however, held financial statements claiming that they had positive returns in September 2008. But as they rushed to take their funds out of the market, they soon found out, on December 12, 2008, that not only did they *not* have positive returns for 2008, but they had no funds at all.

Unlike other fraud victims who feel too ashamed at their own ignorance and greed to grouse too loudly, Madoff victims could find confidence in numbers. Victims could not feel too ashamed at having been swindled when highly respected persons such as Elie Weisel and Steven Spielberg were swindled for more. Victims converged on the internet and even gained representation from an attorney in their midst and from well-known law firms. They started websites, wrote letters, and protested in front of the courthouse during Madoff hearings. In short, they mobilized and told their stories.

Madoff's victims were given several opportunities to be heard during his prosecution and sentencing. Madoff entered a plea of guilty on March 12, 2009, and the court allowed victims to speak on the limited issue of whether the guilty plea should be accepted to be heard in open court.[76] However, many victims felt that the guilty plea robbed them of the intangible benefits of a trial[77] and perhaps kept Madoff in control of his destiny.[78] Perhaps because of this, prior to Madoff's sentencing, victims sent e-mails to the court requesting to be heard and describing their losses.[79] After a

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76. *See* Press Release, United States v. Madoff, 90 Cr. 213 (Mar. 11, 2009), *available at* http://www.justice.gov/usao/nys/madoff/madoffpressreleasecourt.pdf (explaining how victims wishing to speak as to whether the court should accept a guilty plea and as to whether the defendant should be released on bail could place their names on a sign-in sheet the next morning before the plea hearing would begin); *see also* Plea Transcript, *supra* note 6, at 39-41 (transcribing testimony by two victims who wanted the court to reject the plea). The court remanded Madoff to prison awaiting sentencing, and unsurprisingly, no victim present objected. *See id.* at 49.

77. *See* Plea Transcript, *supra* note 6, at 40 ("If we go to trial, we will show our people in this struggling country and the world, who looks to us as the global moral leader, that we hold all people accountable. If we go to trial, we can show all our world that all crimes, all crimes, including crimes of greed, can be dissected, ruled upon, and punished.") (statement of investor–victim).

78. *See id.* at 39 (transcribing testimony of victim at plea hearing that she did not want the plea to end the search for additional wrongdoers and conspirators).

79. Judge Chin had ordered that victims be contacted via the internet to identify themselves to the court and to request to be heard in court, if desired. *See* Order Regarding

request from news sources to make these e-mails, which were under seal, available to the public, victims were asked for permission to unseal their statements.[80] From those released e-mails the prosecution chose 113 to present to the Court as victim impact statements.[81]

A. Victim Impact Statements

From these statements, certain patterns emerge: First, many victims felt that Madoff was somehow responsible for the economic downturn.[82] Even those that did not label Madoff a cause of the economic downturn associated their troubles with the double-whammy of Madoff fraud and recession.[83]

Second, many believed that Madoff's fraud proves him to be of unparalleled evil.[84] Victims repeatedly referred to Madoff as a monster[85] and a murderer[86] and even compared him to Adolph Hitler.[87] Victims had been

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Victim Notification, United States v. Madoff, 08 Mag. 2735 (S.D.N.Y. Mar. 6, 2009), *available at* http://www.justice.gov/usao/nys/madoff/030609order.pdf.

80. *See* Memorandum Decision at 10-12, United States v. Madoff, 09 Cr. 213 (S.D.N.Y. June 17, 2009), *available at* http://www.justice.gov/usao/nys/madoff/madoffsealeditemsfinal2.pdf (unsealing emails in unredacted form from senders who either consented to disclosure or who did not respond to the court's inquiry).

81. U.S. Attorney's Letter and Attached Victim Impact Statements, United States v. Madoff, 09 Cr. 213 (S.D.N.Y. June 15, 2009), *available at* http://msnbcmedia.msn.com/i/CNBC/Sections/News_And_Analysis/_News/__EDIT%20Englewood%20Cliffs/STOCK%20BLOG/Madoff.pdf [hereinafter Victim Impact Statements].

82. *See id.* at 5, Letter from Ronnie Sue and Dominic Ambrosino to Judge Chin (June 8, 2009) ("I can use every superlative in the dictionary, but none would suffice to tell you how damaging Madoff's scheme was, not only to those who invested with him, but to the entire country. His actions have changed our financial structure and have hurt us all."); *id.* at 64, Letter from Richard B. Shapiro to Judge Chin (June 4, 2009) ("Madoff has shattered many people's lives and their 'American Dream.' Our financial markets lay naked with respect to integrity and protection for investors, and our country will suffer for many years ahead the consequences of this crime.").

83. *See id.* at 99, Letter from Robert F. and Suzanne T. Hicks to Senators Baucus, Grassley, and United States Senate Finance Committee members (Mar. 13, 2009) ("Also we must consider selling our house in the present market, or try to find employment in the current economy.").

84. *See, e.g., id.* at 27, E-mail from Allan Goldstein to Judge Chin (June 10, 2009) ("[M]r. [M]adoff has committed a crime against humanity considering all the lives he has wrecked along with charities he destroyed. [H]e should be made to pay for his wicked deeds.").

85. *See id.* at 13, Letter from Jesse L. Cohen, Marcia Cohen, and Larry Cohen to Judge Chin (June 10, 2009) ("Madoff is a thief and a monster."); *id.* at 34, Letter from Norma Hill to Judge Chin (June 2, 2009) ("[T]here is nothing human about this man. He is truly a monster.").

86. *See id.* at 31, E-mail from Stephanie Halio to Judge Chin (June 1, 2009) ("He killed us. . . . Madoff has killed tens of dozens of charities, three generations in so many families."); *id.* at 41, Letter from Phyllis Lerner to Judge Chin (June 6, 2009) ("You, Bernard

asked to comment on Madoff's sentencing, but many admitted believing that no prison term would be proportionate to the magnitude of Madoff's crime.[88] Some victims referred to the ongoing and continuous nature of the Ponzi scheme as proving that it was equivalent to thousands and thousands of individual crimes.[89]

Third, the victim statements agree that the losses incurred by Madoff's victims are of unparalleled devastation. Again, some seem to equate their situations with those of Holocaust survivors.[90] Many describe the effects of the fraud as catastrophic, and more than a few wonder aloud why they are not eligible for government assistance, just as victims of natural disasters[91] and terrorist acts are.[92]

Madoff . . . . You are a murderer. There have already been two suicides that have been publicly attributed to your deeds. . . . You are a rapist. You have stolen one of the most intimate of personal properties, the self esteem and fruits of a life's work. You have ravaged dreams[.] You are a larcenist. . . . You committed 'generational theft.'") (emphasis omitted).

87. *See id.* at 20, Letter from Natalie Erger to Judge Chin (undated) ("History shows us that there are monsters who think that they are above the law. Laws of humanity and common decency don't apply to them because they have created their own world in which they are the Supreme Being. There are many examples, Adolph Hitler, Saddam Hussein and Bernard Madoff. . . . Extreme, I don't think so. Bernard Madoff annihilated thousands for his own gain just as surely as the aforementioned did. He has destroyed the achievements of generations past and the promises of generations to come.").

88. *See id.* at 16, Letter from Michael De Vita to Judge Chin (June 1, 2009) ("Mr. Madoff was a thief. Not just an ordinary thief who stole money. This man stole people[']s lives, eviscerated retirement plans, and ruined family wealth and inheritance. . . . A theft of this magnitude simpl[y] cannot be adequately punished by our legal system. The most that you can do is ensure that he never takes a breath of air as a free man. While insufficient, it is not only the most that you can do, it is also the least that you should do."); *id.* at 31, E-mail from Stephanie Halio to Judge Chin (June 1, 2009) ("We worked and saved for all of [our] lives to be secure in our old age and this monster, this criminal, Bernie Madoff took everything away from tens of thousands of people across this country and the world. If he were tortured for the rest of his life, it wouldn't be enough punishment.").

89. *See id.* at 26, Email from Abby Frucht to Judge Chin (June 1, 2009) (estimating based on falsified weekly statements for twenty years, "that Bernard Madoff lied to them, and stole from them, one thousand and forty separate times. He deserves to stay in prison for at least that many years.").

90. *See id.* at 19-20, Letter from Natalie Erger to Judge Chin (undated) ("It's very hard to go on. Madoff investors are victims of a catastrophic event. . . . [L]ike the Holocaust survivors before us we won't be alive to see restitution and if we are the process is only adding to our hardship."); *id.* at 31, E-mail from Stephanie Halio to Judge Chin (June 1, 2009) ("He is cruel, amoral and a killer. . . . It's like people in the concentration camps during WW II watching the Nazis enjoying themselves using the property, money and other possessions that they had stolen.").

91. *See id.* at 39, Email from K. Kohl to Judge Chin (June 10, 2009) ("When a disaster hits Federal and state governments step in to help those devastated by the disaster offering housing, low interest loans and grants. No such relief has been provided to the victims of the Madoff disaster."). *See also* Rachelle Younglai, *Madoff Victims Seek Help from Congress*, REUTERS, Dec. 9, 2009, http://www.reuters.com/assets/print?aid=USTRE5B83EH20091209

But of course none of Madoff's crimes were violent or resulted in physical harm or death, so comparisons to the Holocaust and the tragedies of September 11, 2001 seem quite misplaced and even offensive. However, many of the Madoff victims seem to honestly believe that the harm of having one's financial security disappear, particularly as the result of a betrayal by a trusted advisor, is a fate worse than death.[93] In fact, quite a few mentioned elderly parents or spouses as being lucky that they had died before the fraud was discovered.[94]

The spectre of continuing life with financial uncertainty seems almost too much for some of the victims to bear. Admittedly, financial conditions of the victims seem to range from relatively unchanged to painfully dire. However, the terror of the victim suddenly faced with a life on a reduced income seems as tangible as the humiliation of the victim on government assistance. Many of the statements refer to lifelong savings disappearing; moreover, many of the victims were related, so middle-aged victims lost college savings at the same time that their parents lost their retirement savings, leaving them to support three generations.[95] Victims at retirement age now face re-entering the job force[96] or living on Social Security payments.[97]

(quoting a lawyer for many of the victims as saying "her clients were not only hit by a 'financial tsunami' when they found out Madoff swindled them, but by a 'second tsunami' when" they realized that the government insurance program Securities Investor Protection Corp. would not reimburse every claimant under its rules).

92. *See* Victim Impact Statements, *supra* note 81, at 110, Letter from John and Beverly Neal to Senators Baucus, Grassley, and United States Senate Finance Committee members (undated) ("It seems that victims of natural disasters in this country and even the poor victims of Sept. 11 had more opportunity for help and assistance than the innocent victims of these terrible frauds perpetrated by what is no less th[a]n financial terrorists.").

93. *See id.* at 71, Email from Jackie Stone to Judge Chin (June 10, 2009) ("It was the beginning of a new kind of death–our family, including my dad, mom, brother, aunt, uncle, cousins–were ALL dead–in one shot. Bernie had killed our family, life, emotions, survival, resource for food, shelter, medicine and our belief in other humans. He DESTROYED our lives in one second!!!!!").

94. *See, e.g.*, *id.* at 36, Letter from Carla R. Hirschhorn to Judge Chin (June 1, 2009) ("I am so thankful that my father died two years ago and was spared from having to live in his terminal condition without the money to provide him 24/7 healthcare, which allowed him to die in dignity."); *id.* at 43, Email from David Levin to Judge Chin (June 4, 2009) ("Fortunately, my father died on February 2, 2008 and was spared the shock of this situation. He was 89 and lived a good long life and this news would have destroyed him psychologically.").

95. *See id.* at 13, Letter from Jesse L. Cohen, Marcia Cohen, and Larry Cohen to Judge Chin (June 10, 2009) ("When you determine Madoff's sentence, I hope you will keep in mind that he has taken not only my twenty-five years of savings, but also the lifetime of savings of my eighty-year-old parents.").

96. *See id.* at 112, Letter from Donald L. Nicolay, MD and Lynn I. Nicolay to Senators Baucus, Grassley, and United States Senate Finance Committee members (Mar. 16, 2009) ("We have had to re-enter the market force at ages 67 and 62. . . . We have been

Objectively, losing savings that one does not depend on for day-to-day expenses[98] seems less of a disaster than death, disability, or other physical catastrophes, such as stroke, cancer, or heart ailments. Victims' stories of selling homes and cars, re-entering the work force, delaying retirement until age seventy or beyond,[99] limiting charitable donations,[100] vacations,[101] and gifts to grandchildren[102] may not seem like horror stories given that many Americans face even more dire economic realities every day. Moreover, some victims' losses might even be amusing to the average American.[103]

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forced to curtail our overseas medical mission endeavors to third world countries, which have included short-term stints in Mexico, Peru, Rwanda and Afghanistan.").

97. *See id.* at 99, Letter from Robert F. and Suzanne T. Hicks to Senators Baucus, Grassley, and United States Senate Finance Committee members (Mar. 13, 2009) ("As a result, our retirement has been turned into a survival situation. No retirement trips, no financial help to children and grandchildren, and the need to survive only on social security income. Also we must consider selling our house in the present market, or try to find employment in the current economy.").

98. *See id.* at 23, Email from Phyllis Feiner to Judge Chin (June 10, 2009) ("Our investment in Madoff grew from inheritance money, which represented my father's life savings. Our comfort zone has been destroyed by Bernard Madoff.").

99. *See id.* at 88, Letter from Tim and Patty Daley to Senators Baucus, Grassley, and United States Senate Finance Committee members (undated) ("After selling the business my plan was to spend more time with the kids I had no time for over the last 20 years. That is not going to happen. I continue to work and will for years to come to keep my promise [to fund education] to my girls.").

100. *See id.* at 108, Letter from Conard and Patricia Metcalf to Senators Baucus, Grassley, and United States Senate Finance Committee members (Mar. 13, 2009) ("We no longer are able to contribute to any charities. Not even our church. And we are going to have to sell our home, in this depressed real estate market, simply to pay the costs of daily living.").

101. *See id.* at 101, Letter from Ross P. and Dorothy J. Jackson to Senators Baucus, Grassley, and United States Senate Finance Committee members (Mar. 14, 2009) ("While we are very physically active people and in general good health, we have had to amend our life style by eliminating all charitable contributions, eating out and extensive travel.").

102. *See id.* at 76, Letter from Judith Welling to Judge Chin (June 5, 2009) ("We have now seen most of our nest egg destroyed and along with it our ability to help fund the education of our nine grand children, make charitable gifts and enjoy a worry free retirement. No punishment could be severe enough to compensate for what transpired."); *id.* at 19, Letter from Natalie Erger to Judge Chin (undated) ("My grandson has a learning disability and I have always helped with money for tutors. My children and grandchildren come to visit for the holidays and I always paid for the air line tickets. How often will I get to see them now? We have eleven grandchildren you can imagine checks for birthdays and holidays. We have always given. I think that is the hardest thing of all. It's bad enough that we can't give anymore we now have to come to our children and siblings for money to survive.").

103. *See id* at 64, Letter from Richard B. Shapiro to Judge Chin (June 4, 2009) (asking the Court without irony "How do we explain to our 8 year old son that we had to 'send away his horse' since it was a luxury we could no longer afford?"); *id.* at 117, Letter from Ted and Sue Rehage to Senators Baucus, Grassley, and United States Senate Finance Committee members (Mar. 13, 2009) ("As a result, our traveling will be curtailed with no more 9 or 10 weeks with the grandkids which is disappointing for all of us. Now it will be a week or two in state at best.").

However, the trauma caused by Madoff seems to be more complex than mere financial loss. Victims want to tell life stories of how they scrimped and saved for a pleasant retirement. Now, this scrimping and saving seems all for naught as the comfortable end-of-life they expected is now out of reach;[104] in other words, the American Dream was stolen from them.[105] Their nest-egg losses seem to make them question a lifetime's worth of decisions.[106] Perhaps more importantly, they have been robbed of security in their senior years.[107] Days that should be relaxing and calm are now suffused with worry over bills and expenses.[108] The loss of investment income may also signal the end of independence as victims find they must move in with relatives. Though the statements themselves may seem a catalog of large and small diminishments in fortune with which many are familiar, perhaps the victims were helpless to fully articulate the impact of the loss of financial security and independence, and thus relied on mundane facts to tell the story.

B. Sentencing "Extraordinary Evil"

Under the federal sentencing guidelines, prosecutors calculated the maximum sentence for the eleven counts as 150 years and recommended that sentence.[109] Madoff's attorneys asked for twelve years.[110] At the sentencing hearing on June 29, 2009, Judge Chin granted the right to speak to

104. *See id.* at 46, Letter from Sue Marshall to Judge Chin (June 3, 2009) ("I am a victim that lost everything, not just money, but my goal of living my senior years with the ability to provide basic common necessities for myself. Dreams are gone, a sense of security is gone and the void is filled with fears, questions, uncertainty and sadness.").

105. Several victims mentioned the American Dream. *See, e.g.*, *id.* at 52, Letter from William and Grace Mishkin to Judge Chin (June 2, 2009) ("He has deprived us of the American expectation of a reasonably comfortable old age.").

106. *See id.* at 53, E-mail from Candace Newlove to Wendy Olsen (June 1, 2009) ("[T]he saddest part of all of this is that [I] made a choice to work 80 hours a week to provide for my girls and [I] missed out on their growing up and now [I] have nothing to give to them in exchange for them not having me around . . . .").

107. *See id.* at 15, Letter from Emma De Vita to Judge Chin (undated) ("The money invested with Madoff was accumulated over a lifetime to ensure a secure personal retirement and as a means of helping to fund the education of my great grandchildren. These two achievable goals are nothing but a distant dream caused by the nightmare of Madoff's actions.").

108. *See id.* at 17, Letter of Sheila Ennis to Judge Chin (Mar. 10, 2009) ("Because of this theft, my Mother's life has drastically changed and I have seen her age and become more and more frail right before my eyes. She is very scared and has totally lost her independence. She will have to move into my or my sister's home which is not how she intended to live out her years. My Mother and Father worked so hard throughout their lives so that they could enjoy their retirement and have funds to pass on to the next generation as well as support many worthy causes.").

109. *See* Sentencing Memorandum, *supra* note 30, at 1.

110. *See id.* at 15.

all victims who requested to be heard. As expected, they all urged the Court to sentence Madoff to the maximum sentence in a maximum security prison.[111] After Madoff made a very short statement, in which he confessed to "an error in judgment,"[112] Judge Chin sentenced Madoff, then seventy-one years old, to the maximum sentence of 150 years;[113] under the federal system, he will not be eligible for release during his natural lifetime.

Judge Chin noted several things in defending the sentence. First, he said that no other financial fraud case from the Southern District of New York was "comparable to this case in terms of the scope, duration and enormity of the fraud, and the degree of the betrayal."[114] Second, Judge Chin noted that unlike other financial fraud cases, no one testified or wrote letters on Madoff's behalf as to his character or otherwise.[115] Third, Judge Chin foreshadows his sentence by stating that the symbolism of a large sentence is necessary to send a message "that Mr. Madoff's crimes were extraordinarily evil, and that this kind of irresponsible manipulation of the system is not merely a bloodless financial crime that takes place just on paper, but that it is instead, as we have heard, one that takes a staggering human toll."[116]

But most interestingly, Judge Chin talks about the victims, and uses their own language, their own narrative. Judge Chin refers to the "staggering human toll" that "we have heard" in the courtroom that day from the victims.[117] He personalizes the victims, telling their stories for them:

> I received letters, and we have heard from, for example, a retired forest worker, a corrections officer, an auto mechanic, a physical therapist, a retired New York City school secretary, who is now 86 years old and widowed, who must deal with the loss of her retirement funds. Their money is gone, leaving only a sense of betrayal.
>
> I was particularly struck by one story that I read in the letters. A man invested his family's life savings with Mr. Madoff. Tragically, he died of a heart attack just two weeks later. The widow eventually went in to see Mr. Madoff. He put his arm around her, as she describes it, and in a kindly manner told her not to worry, the money is safe with me. And so not only did the widow leave the money with him,

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111. *See, e.g.*, Sentencing Transcript, *supra* note 5, at 20-21 ("We urge your Honor to commit Madoff to prison for the remainder of his natural life, and when he leaves this earth virtually unmourned, may Satan grow a fo[u]rth mouth where Bernard L. Madoff deserves to spend the rest of eternity.") (statement of investor–victim).

112. *Id.* at 37 ("I believed when I started this problem, this crime, that it would be something I would be able to work my way out of, but that became impossible. . . . I made a terrible mistake, but it wasn't the kind of mistake that I had made time and time again, which is a trading mistake. . . . My error was much more serious. I made an error of judgment.").

113. *See id.* at 49.

114. *Id.* at 46.

115. *See id.* ("The absence of such support is telling.").

116. *Id.* at 47.

117. *Id.*

> she eventually deposited more funds with him, her 401(k), her pension funds. Now, all the money is gone. She will have to sell her home, and she will not be able to keep her promise to help her granddaughter pay for college.[118]

The effect of these victim impact statements on Judge Chin's sentence was obviously substantial.

The judge in Frank DiPascali's case also invited victims to tell their stories.[119] At the hearing at which DiPascali waived indictment and pleaded guilty to ten criminal counts, one victim asked to be heard.[120] This Madoff client, Miriam Seigman, was disturbed that the two men who knew the most about the fraud would escape trial, giving the victims no information as to how or why this fraud was perpetrated.[121] Judge Sullivan replied that a criminal trial could not serve the goals of a more ambitious tribunal, like a truth commission,[122] possibly drawing an analogy to extreme situations in which truth commissions have operated such as post-genocide Rwanda and post-apartheid South Africa. Having reinforced the idea that Madoff's fraud "decimated" families in the same way that war and genocide have, Judge Sullivan may have been swayed by this narrative as he denied bail, even though the prosecutor objected because DiPascali was a cooperating witness for the government.[123] Both DiPascali and the government asked for reconsideration of bail, and again Judge Sullivan asked if any victims would like to give a statement on whether DiPascali should be free on bail pending sentencing.[124]

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118. *Id.* at 48.

119. *See* DiPascali Plea Transcript, *supra* note 26, at 59-60. Pursuant to a notice on the Department of Justice's website page devoted to Madoff proceedings, the judge invited victims who wanted to be heard at DiPascali's plea hearing to attend that hearing. *Id.* at 59. In addition, the judge put out a sign-in sheet at the hearing and even asked those attending if they would like to raise their hand and be heard. *Id.*

120. *See id.* at 59.

121. *See id.* at 61-63 ("These crimes have affected thousands of men, women, and children, whole generations of families have been decimated, children, parents, dependents who are ill. None of these victims knows how or why this has happened to them. The defendants won't say a word until today, even then very little, and the prosecutors have said very little to victims.").

122. *Id.* at 64.

123. *See id.* at 91 (ordering remand without prejudice).

124. *See* Order, United States v. DiPascali, 09 Cr. 764 (S.D.N.Y. Dec. 17, 2009), *available at* http://www.justice.gov/usao/nys/madoff/20091217orderreconsiderationofbail.pdf.

C. Restitution, Remission, and Compensation

1. *Restitution*

Madoff victims have two avenues of possible compensation for their losses. First, the Department of Justice will seize assets of the defendant and remit liquidated funds from those assets pro rata to claimants who suffered a pecuniary loss as a direct result of the illegal act. In this case, restitution is mandatory,[125] but given the complexity of the case, restitution was not available at sentencing and has been directed to the DOJ as part of a remission of forfeiture proceeding,[126] which is now part of the bankruptcy proceedings. This process is understandably lengthy, given the number of claimants and the difficulty in seizing Madoff's assets. In addition, this process will not provide full compensation for even the victims' principal investments. Although the Final Order of Forfeiture entered on June 26, 2009, contained forfeiture allegations totaling a money judgment against Madoff in the amount of $177 billion,[127] only a fraction of that will ever be recovered.[128]

While Madoff's records showed 4,902 active customer accounts as of December 11, 2008, 8,094 customer accounts were active during the period from 2000-2008. However, 15,870 claimants filed applications for restitution. Part of this difference is because eighty-three of the active customer accounts were not in the name of individuals, but in the name of other financial firms—the "feeder funds"—which invested their own clients' funds in BLMIS. Determining eligibility of each of these claimants, and the amount of each claim, is ongoing.

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125. *See* 18 U.S.C. § 3663A(a)(1) (2006).

126. *See* Order, United States v. Madoff, 90 Cr. 213 (S.D.N.Y. Sept. 24, 2009), *available at* http://www.justice.gov/usao/nys/madoff/20090924orderforegoingmandatory restitutionecf.pdf (ordering that restitution was impracticable and ordering that the government proceed through the process of remission as authorized under the forfeiture statutes). *See also* 18 U.S.C. § 3663A(c)(3) (2006); 21 U.S.C. § 853(i) (2006).

127. *See* Government's Memorandum in Support of Its Motion Pursuant to Title 18, United States Code, Section 3663A(c)(3) at 6, United States v. Madoff, 09 Cr. 213, (S.D.N.Y. Sept. 22, 2009), *available at* http://www.justice.gov/usao/nys/madoff/20090922 remissionbrieffinalwithexs.pdf.

128. As of November 11, 2009, the Madoff trustee reported having $18.7 billion under his control. *See Statement of Proposed Testimony of Stephen P. Harbeck: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 111th Cong. 2 (2009) (statement of Stephen P. Harbeck, President and CEO of Securities Investor Protection Corporation).

2. *SIPC Compensation*

Second, some of the Madoff victims have recourse to compensation by the Securities Investor Protection Corporation (SIPC), an entity created and governed by the Securities Investor Protection Act (SIPA).[129] Although investment accounts are not guaranteed by the FDIC in the same ways as are deposit accounts at commercial banks, investment accounts are protected by the SIPC up to $500,000.[130] Though not characterized as insurance, SIPC acts to advance funds to investors of failed firms quickly, up to the statutory limit. Should the firm's assets be insufficient to advance any additional funds, investors' only satisfaction will be from SIPC funds. In the Madoff SIPC liquidation, victims dispute the calculation of their losses by the SIPC Trustee, Irving Picard.[131]

Victims argue that their losses are equal to the amounts they were told were in their BLMIS accounts as of their last statement.[132] Conversely, the SIPC takes the position, which has some unclear case law precedent,[133] that the victims' losses are equal to the principal amounts they invested minus

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129. 15 U.S.C. §§ 78aaa-lll (2006).

130. 15 U.S.C. § 78fff-3 (2006) (providing that SIPC should advance to a bankruptcy trustee up to $500,000 for each customer to satisfy claims according to a customer's "net equity").

131. For example, a group of victims asked Judge Chin to reconsider his September 24, 2009 Order for the government to proceed through the process of remission given that restitution by sentencing was impracticable. *See* Order at 1-2, United States v. Madoff, 09 Cr. 213 (S.D.N.Y. Oct. 28, 2009), *available at* http://www.justice.gov/usao/nys/madoff/20091028chinorderdenyingreconsiderationofremissionruling.pdf. The victims, however, did not disagree with the court but wanted to object to the court possibly appointing Irving Pacard, the SIPA Trustee, as the Trustee for remission of forfeiture. *Id.* at 2 (denying victims' motion for reconsideration and declining to intervene in the government's appointment of Irving Picard).

132. *See* Chaitman Testimony, *supra* note 14 (arguing that SIPC has no legal basis to calculate net equity as anything other than amounts listed on monthly statements).

133. *In re* New Times Sec. Servs., Inc., 371 F.3d 68 (2d Cir. 2004) (determining claims for investors whose advisor had promised to purchase specific securities of a fictitious mutual fund and to purchase specific legitimate securities, but never purchased any securities). Unfortunately, this case is similar, but not identical to the Madoff case, in which Madoff never promised any investor anything specific with regard to investing the money, but recorded fictitious trades in specific legitimate securities in historical financial statements. *Additional Reforms to the Securities Investor Protection Act: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 111th Cong. (2009) (statement of Michael A. Conley, Deputy Solicitor, SEC), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/conley_testimony.pdf ("The Madoff liquidation does not fall neatly within the situations expressly addressed by SIPA or dealt with in cases interpreting the statute.").

the distributions they have taken over the years.[134] Though victims were invited to speak at Madoff's sentencing only on the topic of sentencing, many could not resist addressing the issue of the SIPC calculations.[135]

For example, if an investor placed a $100,000 inheritance with Madoff in 1985 and believed that in 2008 it had grown to $400,000, then the investor argues the loss is $400,000, but SIPC argues the loss is $100,000. In addition, if that investor took out $50,000 in 2001 to send a child to college, then SIPC argues the loss is $50,000. If the investor sent two children to college at $50,000 each, then SIPC argues that there is no loss and no valid claim, regardless of whether the last statement falsely led the investor to believe that she had a nest egg of $400,000 and regardless of the investor's actions in reliance on that belief. In addition, the loss is estimated at $100,000 regardless of inflation or concepts of the time value of money.

The purpose behind SIPC is to provide minimum guarantees that investment principal has been invested as requested, not to guarantee a return. Had Madoff been actually investing the $100,000 for twenty-three years, that amount may have doubled twice, but it may have dissipated during economic downturns or because of unwise investment choices. SIPC's goal is to compensate for fraud, not for either economic downturns or unwise investment choices. In addition, SIPC has a more basic reason not to compensate for "phantom losses." SIPC does not have enough money to compensate each Madoff investor for those losses.[136]

Madoff victims may be able to re-shape the law, however. In December 2009, victims lobbied Congress to change SIPC laws to allow victims to recover based on the amounts they were falsely told were in their invest-

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134. *See* Diana B. Henriques, *A Year Under Fire: At SIPC, Chief Struggles with Madoff Claims and Victims' Pain*, N.Y. TIMES, Dec. 9, 2009, at B1 (quoting Harbeck as saying that the courts have never allowed phantom Ponzi scheme losses to be calculated to include phantom returns the investors thought they had earned).

135. *See, e.g.*, Sentencing Transcript, *supra* note 5, at 16 ("We have been betrayed by SIPIC, which in order to save money, has invented a new definition of net equity to deprive us of the $500,000 of insurance of which we were assured.") (statement of investor–victim); *id.* at 30 ("SIPIC has now redefined what we are entitled to.") (statement of investor–victim).

136. *See* Younglai, *supra* note 91 (quoting the chairman of the House Financial Services subcommittee as saying "We don't have the funds" to make all victims whole). One issue surrounding the funding of SIPC is that until recently, members' firms paid a flat fee of $150 a year, regardless of the size of the firm, a premium that does not contemplate a securities fraud on the scale of the Madoff fraud. In fact, SIPC normally has a reserve fund of $1.7 billion, with borrowing privileges of an additional $1 billion. *See* Henriques, *supra* note 134, at B1. However, in response to this shortfall, SIPC has instituted a new assessment of one-fourth of one percent of net operating revenues, effective beginning with fiscal years ending in April 2009. *See* Letter from Armando J. Bucelo, Jr., Chairman, SIPC, to CEOs, SIPC Member Firms (Mar. 2, 2009) *available at* http://www.sipc.org/SIPCassessment notice-march22009.pdf.

ment accounts.[137] Victims have also complained about the pace of reimbursement efforts and the underfunding of SIPC.[138] On February 2, 2010, represented by heavy-hitting law firms such as Milberg LLP, Davis, Polk & Wardell, and Sonnenschein Nath Rosenthal LLP, victims were given a chance to appear in a hearing regarding the calculation of "net equity" in front of the bankruptcy court.[139] Though the bankruptcy judge ruled in favor of SIPC on the "net equity" issue,[140] the court certified its ruling to allow for immediate appeal to the Federal Court of Appeals for the Second Circuit.

SIPC rules also count only direct customers in BLMIS as eligible for SIPC compensation. In other words, individual clients of feeder funds must look to that fund for compensation.[141] SIPC will pay out eligible amounts to the fund. Therefore, if a particular fund invested $50 million in client funds, that fund is eligible for a maximum of $500,000 in compensation.[142] Of course, indirect investors have the ability to sue the fund in which they invested for fraud or negligence.[143]

Lastly, the SIPC trustee has the ability to "claw back" funds paid to investors while the fund was insolvent, going back six years.[144] Because the

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137. *See* Younglai, *supra* note 91 (describing victim testimony in front of the U.S House of Representatives Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises).

138. *See id.*

139. *See* Diana B. Henriques, *In Court, Impassioned Challenges of Madoff Trustee's Plans*, N.Y. TIMES, Feb. 3, 2010, at B1 (noting that the court reserved judgment for a later time in the "Solomonic" decision); *see also* Memorandum of Law of the SIPC in Support of Trustee's Motion for an Order Upholding Trustee's Determination Denying "Customer" Claims at 6, Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC, Adv. Pro. No. 08-01789 (SIPA Liquidation) (Bankr. S.D.N.Y. Oct. 16, 2009), *available at* http://www.sipc.org/pdf/519_Memorandum_of_Law-1.pdf.

140. *See In re* Bernard L. Madoff Inv. Sec., LLC, No. 08-01789, 2010 WL 694211, at *3 (Bankr. S.D.N.Y. Mar. 1, 2010).

141. *Additional Reforms to the Securities Investor Protection Act: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 111th Cong. (2009) (statement of Peter J. Leveton, Co-Chairman of Agile Funds Investor Committee), *available at* http://www.house.gov/apps/list/ hearing/financialsvcs_dem/leveton.pdf (testifying that "[a]ll [i]ndirect investors should be entitled to the same financial relief as the [d]irect investors" and that Congress should "[e]liminate [d]iscrimination [a]gainst [i]ndirect [i]nvestors").

142. *See* Sec. Investor Prot. Corp. v. Morgan, Kennedy & Co., 533 F.2d 1314, 1317-21 (2d Cir. 1976) (holding that the 108 employee beneficiaries of one employee profit-sharing plan constituted one customer for purposes of SIPC recovery); *see also All Things Considered: SIPC May Rescue Madoff Victims* (NPR Radio broadcast Dec. 31, 2008), *available at* http://www.npr.org/templates/story/story.php?storyId=98913273 [hereinafter *All Things Considered*] (interviewing Professor John Coffee, Jr., who estimated that $7.3 billion worth of client investments came through indirect investors).

143. *See All Things Considered*, *supra* note 142 (noting that "[t]here definitely will be litigation against . . . feeder funds," particularly the ones that pursued the undiversified strategy of investing most, if not all, client funds with Madoff).

144. 15 U.S.C. § 78fff-2(c)(3) (2006).

advisory fund was always insolvent, and more so every year, any distribution to investors was necessarily made from other investors' funds. Theoretically, all of the distributions should be returned to one pot, giving all defrauded investors pro rata slices of the same pie, regardless of whether they were lucky enough to redeem early.[145] In addition, this mechanism guards against fraudsters who see the end is near, giving preference to friends and family.[146] In April 2009, the Madoff trustee sent letters to 223 victims notifying them that money they had received from Madoff may be subject to clawback, though certain defenses may apply.[147] Certain Madoff feeder funds had received earlier letters. However, as of December 2009, the trustee had instituted clawback proceedings against only three "small investors" who initiated proceedings against the trustee, as counterclaims.

Arguably, the trustee has used this power "judiciously" in response to the enormous public criticism of the clawback threat by the Madoff victims.[148] Many of the victim impact statements focused on the threat of clawback as a further trauma to their families.[149] In addition, attorneys on behalf of the victims had filed a motion in Madoff's prosecution asking the judge to reconsider ordering restitution in the case to be administered by SIPC if the SIPC trustee, Irving Picard, was going to be the trustee.[150] Per-

145. *See* Miriam A. Cherry & Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 395-96 (2009) (explaining the difference between winning investors and losing investors and how disgorgement may benefit innocent losing investors at the expense of innocent winning investors).

146. *Additional Reforms to the Securities Investor Protection Act: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs.*, 111th Cong. (2009) (statement of John Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School), *available at* 2009 WL 4647558 (describing the theory behind clawbacks and fraudulent conveyance law as "the crook should not be able to choose his victims") [hereinafter Coffee Testimony].

147. *See* Tally M. Wiener, *On the Clawbacks in the Madoff Liquidation Proceeding*, 15 FORDHAM J. CORP. & FIN. L. 221, 228 (2009).

148. *See* Coffee Testimony, *supra* note 146 (describing how the prospect of clawback "has provoked outrage and shock from many of the persons so sued, who point out that they did suffer significant losses, which may yet be compounded significantly by the trustee's actions").

149. *See, e.g.*, Victim Impact Statements, *supra* note 81, at 36, Letter from Carla and Stanley Hirschhorn to Judge Chin (June 1, 2009).

150. Memorandum of Law in Support of Victims' Motion for Reconsideration, United States v. Madoff, No. 09-Cr-213 (S.D.N.Y. Sept. 30, 2009), 2009 WL 3811829. Judge Chin denied the motion and ordered remission, holding that his order did not purport to determine which victims or categories of victims were not entitled to relief. Order at 2, United States v. Madoff, 09-Cr-213 (S.D.N.Y. Oct. 28, 2009) ("Finally, to the extent the victims object to the government's possible retention of Mr. Picard to assist in the remission process, even assuming I have the power to block the government from doing so, I decline to exercise that power.").

haps, fearing additional backlash, the Madoff trustee chose to go after only the biggest and smelliest fish.[151]

Unlike other victims of lesser-known fraudulent scams that are discovered by the Securities and Exchange Commission every year, the Madoff victims are having some success framing their plight as one of disaster in which government intervention is necessary and prudent. In fact, Harvey Pitt, former chairman of the SEC, has said that officials at SIPC should disregard stringent rules and "stand up for those who have been defrauded by a master swindler."[152] However, that generosity of spirit may deplete coffers for those in 2010 who have been defrauded by garden-variety swindlers.[153]

3. *Tax Relief*

Madoff victims have been very vocal and have turned to federal legislators, not only to reform SIPC rules but also to aid them in their search for tax relief. Though the bankruptcy trustee was not calculating phantom gains as compensable losses, many victims had paid taxes on the fictitious returns. In March 2009, after victims urged Congress to create legislation to help them, the Internal Revenue Service agreed to allow victims to deduct up to ninety-five percent of their losses immediately, and carry back net operating losses five years or forward twenty years.[154] More importantly, the IRS issued guidelines that victims could deduct not only lost principal, but also phantom losses.[155] Therefore, the investor discussed earlier may be

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151. Though few individuals have been pursued by Picard, Stanley Chais, Carl Shapiro, and Jeffry Picower not only have been the subject of clawback proceedings, but have also been indicted. According to the prosecutors, Shapiro and Picower received much higher returns than other clients routinely received, as much as 950% a year in the case of Picower. *See* ARVEDLUND, *supra* note 8, at 235. Picower, who took out $6.7 billion from his account over the years, also may have asked Madoff to generate phantom losses for tax purposes, suggesting that he knew that it was all a fiction anyway. *See id.* at 235-36 (reporting that of that $6.7 billion, $5.1 constituted phantom returns). However, Picower died in October 2009, further complicating any recovery. *See* Amir Efrati, *Lawyer: Heart Attack Killed Picower*, WALL ST. J., Oct. 27, 2009, at C3.

152. *See* Henriques, *supra* note 134, at B1.

153. *See id.* ("'Nobody likes to say no to people who are, without question, victims . . . But this is a zero-sum game—a dollar we give to someone who is not eligible is a dollar we do not have for someone who is.'" (quoting Stephen P. Harbeck of SIPC)).

154. Rev. Rul. 1-165, 2009-9 C.B. 735. *See also* John D. McKinnon & Jane J. Kim, *Ponzi Scheme Victims Get a Tax Break*, WALL ST. J., Mar. 18, 2009, at A4.

155. *See* Rev. Proc. 2009-20, 2009-14 I.R.B. 749-50:

(1) Qualified investment means the excess, if any, of —

(a) The sum of —

(i) The total amount of cash, or the basis of property, that the qualified investor invested in the arrangement in all years; plus

(ii) The total amount of net income with respect to the specified fraudulent arrangement that, consistent with information received from the specified fraudulent

able to deduct $400,000. These new guidelines could result in substantial tax refunds for past tax years and years to come.[156]

III. THE HISTORY OF THE PONZI SCHEME

Madoff's BLMIS fraud is certainly not the first of its kind. Schemes that promise passive returns at a high rate of interest are very attractive and rarely lack for investors,[157] and this greed fuels the Peter–Paul scheme. Though named after Charles (née Carlo) Ponzi, the "rob Peter to pay Paul"[158] scheme predated him.[159] Ponzi's fraud was a simple one, and his story has been retold many times. Born in Italy to a family with social stature but little wealth, Ponzi failed at university and sought to come to America to make his fortune.[160] Unfortunately, his lack of work ethic and spendthrift ways brought him more trouble than fortune. Fresh off of two prison stints,[161] Ponzi began life anew in Boston, even marrying the love of his life,

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arrangement, the qualified investor included in income for federal tax purposes for all taxable years prior to the discovery year, including taxable years for which a refund is barred by the statute of limitations; over

(b) The total amount of cash or property that the qualified investor withdrew in all years from the specified fraudulent arrangement (whether designated as income or principal).

156. The amount of revenue foregone by the federal government to compensate victims in this way may amount to as much as $17 billion. *See* Marcy Gordon, *IRS: Madoff Victims Tax Relief*, HUFFINGTON POST, Mar. 17, 2009, *available at* http://www.huffingtonpost.com/2009/03/17/irs-madoff-victims-tax-re_n_175713.html.

157. *Cf.* BERNARD SHAW, EVERYBODY'S POLITICAL WHAT'S WHAT? 256 (2d ed. 1950) ("A government which robs Peter to pay Paul can always depend on the support of Paul.").

158. The origins of the phrase "robbing Peter to pay Paul" are unclear. Though widely credited to reference the selling of lands at St. Peter's Church in Westminster to pay for repairs at St. Paul's Cathedral in London, the use of the phrase predates any such transaction. The first record of the phrase's use is by John Wycliffe in *Select English Works* (1380) and may be a variation of a French phrase "as it were that one could crucify Paul in order to redeem Peter." The phrase may also refer to the fact that during the Reformation, church taxes were paid both to St. Peter's in Rome and St. Paul's in London, so skimping on one tax to pay the other would lead to a perverse end.

159. *See* R. Alexander Pilmer & Mark T. Cramer, *Swindlers' List*, L.A. LAWYER, June 2009, at 22, 28 n.1 (describing the fraud of William "520 Percent" Miller, a Boston swindler whose "Peter-to-Paul" scheme brought in $1 million before it collapsed in 1899). Another Boston-based scam with which Ponzi may have been familiar was the Woman's Bank of Boston, managed by Sarah Howe, who paid depositors eight percent returns funded by new depositors until the scheme imploded. *See* George Robb, *Women and White-Collar Crime: Debates on Gender, Fraud and the Corporate Economy in England and America, 1850-1930*, 46 BRIT. J. CRIMINOLOGY 1058, 1067 (2006) (citing *The Woman's Bank of Boston*, BANKER'S MAG., Nov. 1880, at 351-52).

160. *See* MITCHELL ZUCKOFF, PONZI'S SCHEME: THE TRUE STORY OF A FINANCIAL LEGEND 22 (2005).

161. Ponzi v. Ward, 7 F. Supp. 736, 737 (D. Mass. 1934) (reciting the fact of his 1908 forgery conviction in Montreal, prior to his 1910 re-entry into the United States).

Rose. However, money problems were plaguing him when he came upon what seemed like a legitimate arbitrage opportunity. In 1919, residents of the United States and certain foreign countries[162] could purchase an International Reply Coupon[163] at their local post office and send it to loved ones or business colleagues in the other countries. The recipient could then redeem the coupon for return postage, thereby allowing U.S. letter writers to send an equivalent of a "self-addressed, stamped envelope" to increase the speed of a reply. Ponzi realized that because of currency fluctuations, a dollar could buy sixty-six of these coupons in Italy, which could be redeemed in the United States for five cents each or $3.30, a return of more than 200%.[164] Ponzi established a corporation, the Securities Exchange Company, on December 13, 1919, with the purpose of doubling investors' money through speculation in postal coupons.[165] He began recruiting investors by promising them a fifty-percent return on their money within ninety days. In fact, initial investors would receive their profits in forty-five days.[166]

However, his legitimate scheme immediately turned into the Peter–Paul scheme for which it is remembered. First, Ponzi had pressing debts to repay that required him to use his new capital.[167] Ponzi may have rationalized to himself that he would pay off his debts first, and then proceed to use later capital infusions to arbitrage in postal coupons. Surely, with a 230% guaranteed return, he had some time to spare. However, Ponzi never got around to purchasing any coupons, except the dollar's worth he had an Italian acquaintance buy and send to him to ensure the plan could work.[168] Even if Ponzi had figured out the logistics of sending money abroad to finance the purchase of the coupons, the plan would not have worked on a scale of any size. In the United States, International Reply Coupons were generally redeemed for postage, not for cash. Moreover, no post office would have redeemed the number of coupons (at five cents each) necessary to repay a hundred-dollar note, much less thousands of them. In fact, Pon-

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162. International Reply Coupons were issued and honored by countries that were members of the Universal Postal Union, formed in 1874. *See* Universal Postal Union, UPU at a Glance, http://www.upu.int/about_us/en/upu_at_a_glance.html (last visited May 24, 2010). The Universal Postal Union still exists today, guaranteeing orderly international postal delivery among member countries. *See id.*

163. The 1906 Treaty of Rome created the prepayment coupon, to be used by member countries, a vast improvement on foreign postal practices. *See Many Postal Reforms in the Treaty of Rome*, N.Y. TIMES, June 24, 1906, at 20 ("'The importance of this provision . . . cannot be overestimated.'") (quoting Mr. E. Rosewater, delegate).

164. *See* ZUCKOFF, *supra* note 160, at 95.

165. *See id.* at 106-07.

166. *Id.* at 107.

167. *See id.* at 114-15.

168. *See id.* at 114 ("[B]usiness would grow slowly and steadily, Ponzi thought, giving him plenty of time to test, refine, and perfect his cash-for-coupons transfers.").

zi's scheme would have required more coupons than were ever in circulation by an order of magnitude.[169]

Like Madoff, Ponzi began his fraud by recruiting people he knew, many of them also Italian immigrants or Italian–Americans in his Boston neighborhood in January 1920.[170] In fact, many Ponzi schemes can be described as affinity frauds, because community ties and the victim's familiarity with other investors decrease skepticism of the otherwise too-good-to-be-true promises of financial reward.[171] However, as Ponzi's reputation for giving large returns grew, so did his clientele. By the summer of 1920, prospective investors were lined up each morning before the office of the Security Exchange Company opened. Business was so brisk that Ponzi opened twelve additional offices throughout Massachusetts and New Hampshire, two in Vermont, three in Connecticut, two in Maine, three in Rhode Island, and two in New Jersey.[172] In fact, Ponzi's operations probably employed more persons than Madoff's seventeenth-floor operations did.

Unlike Madoff's decades-long swindle, Ponzi's success was short-lived. Perhaps a swift decline was inevitable given the short duration of the notes he issued, but Ponzi's scheme technically did not collapse because he could not honor the repayment of his 50% notes. The sheer popularity of his enterprise, and the fact that many investors re-invested both principal and profits with Ponzi, would have kept the scheme going much longer had he not attracted the attention of both regulators and the press. Yet even when the Boston Press compensated Ponzi's public relations employee to go public with his suspicions that the enterprise was a Peter–Paul scheme, Ponzi was able to fund all investor redemptions that announcement generated.[173] Although he may well have evaded the Boston district attorney's of-

169. *See id.* at 116 (noting that Ponzi would have needed 53,000 coupons to satisfy just the first eighteen investors, "enough to fill a steamer trunk").

170. *See id.* at 219-20 ("'If there is anybody in this country requiring protection at the present time it is the humble Italian immigrant' . . . . 'These poor people from Italy, who are children in finance, come to this country, and many of them take out citizenship papers. They can then be put into the trenches and made to give up their lives in defence of this country. Are we to do nothing to protect their savings and their hard-earned dollars?'" (quoting Clarence Barron, the financial news magnate)). *See also* United States v. Grosky, No. 09 C 4155, 06 CR 359-1, 2009 WL 3064926, at *2 (N.D. Ill. Sept. 22, 2009) (alluding to the nature of a Ponzi Scheme, but remarking "or given the original nature of Charles Ponzi's activities, robbing Pietro to pay Paolo").

171. *See* Sontag, *supra* note 63, at B1 ("'But because he was Indian—it influenced me. It made me not think about things I'd usually think of, given my profession.'" (quoting a business school professor who was a victim of Deepak Gulati, a con artist who targeted immigrants from India)).

172. *See* ZUCKOFF, *supra* note 160, at 124.

173. During the time that Ponzi was being investigated, Ponzi voluntarily stopped taking investments on July 26, 1920, and offered to redeem any unmatured Ponzi notes for 100% of the principal. During the bankruptcy case that followed the demise of Ponzi's scheme, these funds would be "clawed back" as preferences, though note holders argued that

fice,[174] the postmaster general, and the Massachusetts attorney general's office for the time being, he didn't anticipate being exposed by the state bank commissioner, who had investigatory powers due to the fact that Ponzi was a controlling shareholder in Hanover Trust Company, a bank in Boston.[175] Once the commissioner, Joseph Allen, could look behind the accounts at Hanover Trust, he could see the footprints of Ponzi's Peter–Paul scheme and froze all accounts.[176] Probably not coincidentally, three Ponzi investors with a combined investment of less than $750 filed an involuntary petition in court minutes later to declare Ponzi bankrupt. Though Ponzi could have easily satisfied those small claims, he was frozen, helpless, and caught.

Many comparisons can be made between Ponzi and Madoff. Each perpetrated a scheme of a size and scope that was unheard of in his time. Ponzi's scheme generated millions of dollars in a very short period of time,[177] but admittedly, his stranded investments, even in 2008 dollars, would only be in the hundreds of millions, certainly not the tens of billions owed by BLMIS. However, Ponzi's scheme ran from January 1920 to the beginning of August 1920, a matter of months, not decades.[178] Moreover, Ponzi's victims were greater in number than Madoff's victims,[179] though the average investment was more modest. Ponzi's millions also made him one

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they were rescinding these contracts because of fraud and therefore not receiving a preference. Cunningham v. Brown, 265 U.S. 1, 10 (1924) (holding that the 500 note holders that were repaid after July 26 were not rescinding their contracts but were being voluntarily redeemed and that by August 2, those note holders had reason to believe that a fraud had occurred).

174. *See* ZUCKOFF, *supra* note 160, at 221-22 (noting that the local prosecutor ended his investigation while the state investigation was ongoing, telling the press that "the business seemed to have been conducted 'normally' and remarked that Ponzi seemed generous to charity").

175. *See Cunningham*, 265 U.S. at 8-9 (describing Ponzi's movement of money from other regional banks to the Hanover Trust Company).

176. As Ponzi was desperately trying to move money from other banks to Hanover Trust so that regulators would see that his available funds exceeded claims, he miscalculated the size of another account and bounced a check for $331,000. *See id.* at 9. He did not have time to write a smaller check before the bank commissioner pronounced him insolvent. *See* ZUCKOFF, *supra* note 160, at 259-60.

177. *See Cunningham*, 265 U.S. at 8 (calculating that "[w]ithin eight months he took in $9,582,000, for which he issued his notes for $14,374,000"). *See also In re* Indep. Clearing House Co., 41 B.R. 985, 994-95 n.12 (D. Utah 1984) (calculating that at the time the involuntary petition was filed against Ponzi on August 9, 1920, his "outstanding liabilities were $6,948,267.88, and his total assets were $2,195,685.56").

178. At the height of the popularity of his scheme, Ponzi was accepting $1 million worth of deposits per week, surely challenging the success of BLMIS in 2008 dollars. *See Cunningham*, 265 U.S. at 8.

179. ZUCKOFF, *supra* note 160, at 298 (noting that 20,000 investors held unmatured Ponzi notes at the time of his arrest). BLMIS, on the other hand, had 4,900 client accounts at the time that the fraud was discovered. *See* Sentencing Memorandum, *supra* note 30, at 3.

of the richest men in Boston, living a life of luxury, making large charitable donations, and owning the most expensive car made at the time. Just as Madoff's extravagant lifestyle was fueled by the principal of his investors, so too was Ponzi's climb from obscurity to enormous wealth.

Given Madoff's 150-year sentence, the law treated Ponzi quite gently. Ponzi pleaded guilty to one count of federal mail fraud,[180] at the urging of his wife, and was sentenced to five years in federal prison.[181] Had he gone to trial, he would have faced a maximum of twenty years under the law of 1920, not the 150 years under the Federal Sentencing Guidelines.[182]

While serving his federal sentence, he also had to defend himself against state law charges brought by the Massachusetts attorney general,[183] who no doubt felt some embarrassment at not having been the one to get to Ponzi first.[184] Ponzi represented himself and won an acquittal;[185] however,

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180. *See* Ponzi v. Fessenden, 280 F. 1022, 1022 (1st Cir. 1922) ("[On] October 1, 1920, two indictments charging violation of section 215 of the Penal Code were returned against said Ponzi in the District Court of the United States for the District of Massachusetts. November 30, 1920, he was arraigned and pleaded guilty to the first count of one of these indictments, and was sentenced by said court to imprisonment for five years in the House of Correction at Plymouth . . . .").

181. Note that Ponzi's crimes predated both the Securities Act of 1933 and the Securities Exchange Act of 1934, so his central crime was one of state law fraud, though use of the mails made his a federal crime as well.

182. Many of the arguments that the prosecution made in the Madoff case seem not to apply to Ponzi: Madoff's scheme was terrible because it was long-running, because he favored friends and employees over other clients, because it was not born out of economic hardship, because Madoff had "every opportunity to succeed in life through legitimate work," and because Madoff was not forthcoming in disclosing all of his assets. Government's Sentencing Memorandum, United States v. Madoff, No. 09 Cr. 213 (June 26, 2009), *available at* 2009 WL 1899501. However, under the Guidelines, a modern prosecutor may have been able to calculate a lengthy sentence for Ponzi as well. Ponzi was charged with two counts of mail fraud, which would earn him a 40-year sentence. In addition, Ponzi's sentence would have been subject to several enhancements, including affecting more than 250 victims, endangering the financial security of 100 or more individuals, and jeopardizing the safety and soundness of a financial institution, Hanover Trust.

183. Ponzi v. Fessenden, 258 U.S. 254 (1922) (answering certified question in the affirmative as to whether the U.S. Attorney General must execute a writ of habeas corpus filed by the Commonwealth of Massachusetts to have Charles Ponzi appear at state trial against him). Though state authorities have left Madoff's prosecution to federal authorities, state regulators have focused on Madoff's feeder funds. *See, e.g.*, Consent Order at 66-67, *In re* Fairfield Greenwhich Advisors LLC, No. 2009-0028 (Mass. Sept. 8, 2009), *available at* http://www.sec.state.ma.us/sct/sctfairfield/fairfield_consent.pdf (ordering restitution and a $500,000 fine from feeder fund).

184. Ponzi, realizing that his scheme was over, chose to surrender to U.S. Attorney Dan Gallagher on August 12, 1920 on an agreed charge of federal mail fraud, although his minimal use of the mails was possibly not fraudulent. *See* ZUCKOFF, *supra* note 160, at 287. However, Ponzi chose to give the honors to the more sympathetic Gallagher than the Massachusetts attorney general, who actually was able to bring an indictment before the federal prosecutor did. *See Fessenden*, 258 U.S. at 255 (noting that the Commonwealth of Massa-

two years later, the Commonwealth retried him on several counts they did not bring the first time.[186] The second trial resulted in a hung jury, but the third trial brought Ponzi a sentence of seven to nine years.[187] The fact that two out of three juries acquitted Ponzi seems to suggest that he was not vilified by the Massachusetts public.

Public opinion may have also been kinder to Ponzi than to Madoff. A New York Times editorial very evenhandedly described him as "'something picturesque, something suggestive of the gallant about him, and it is almost possible, though not quite, to believe that he was as credulous as his victims and deceived himself as much as he did them.'"[188] In addition, the editorial pointed out that his scheme was fueled by his victims: "'Perhaps the disinclination for being harsh in characterizing Ponzi is due to lack of any sympathy for those whom he robbed. . . . They showed only greed—the eagerness to get much for nothing—and they had not one of Ponzi's redeeming graces.'"[189] Though some investors were understandably outraged, some even blamed themselves for being attracted to one of many get-rich-quick schemes of the day. The bankruptcy proceeding in Ponzi's case was similar to Madoff's bankruptcy, and the trustee moved to claw back some inves-

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chusetts returned twenty-two indictments against Ponzi on September 11, 1920, followed by two federal indictments on October 1).

185. *See* Commonwealth v. Ponzi, 152 N.E. 307, 308 (Mass. 1926) (reciting as background that "[a]t the trial of the 12 [out of 22] indictments, the jury returned verdicts of not guilty on December 1, 1922").

186. *See id.* at 308 (reciting as background that the 1924 trial on five of the indictments resulted in an acquittal on one of the counts and hung jury on the remaining four).

187. *See id.* at 308-09 (noting that Ponzi was sentenced on only one of the four counts, resulting in a finding that he was "a common and notorious thief" and "sentenced to not less than seven nor more than nine years in state prison"). Though Ponzi appealed, none of his issues on appeal were sustained and his conviction was upheld. *See id.* (overruling both evidentiary objections and double jeopardy objections based on the fact that the federal charges of mail fraud were distinct from state law charges of larceny, conspiracy to commit larceny, and being an accessory before the fact to larceny). Following his release from state prison, Ponzi was deported to Italy. *See* Ponzi v. Ward, 7 F. Supp. 736, 737 (D. Mass. 1934) (dismissing all objections to Ponzi's being deported under the Immigration Act of 1917 for being "sentenced more than once to imprisonment for a term of one year or more, because of conviction in this country of a crime involving moral turpitude").

188. ZUCKOFF, *supra* note 160, at 293-94.

189. *Id.* at 294.

tors' gains.[190] However, some investors voluntarily gave back their returns once they realized they were ill-gotten gains.[191]

The general public may have had other crimes with which to compare Ponzi's crimes as subsequent news stories made Ponzi's scheme not seem as rare and bizarre as Madoff's. Not only did Hanover Trust fail, but several other Boston banks failed shortly thereafter, due to the misdeeds of their own bank officers. Moreover, another Peter–Paul scheme with offices down the hall from the Securities Exchange Corporation, the Old Colony Foreign Exchange, failed shortly thereafter when its investors realized that it was a Ponzi copycat.[192] More broadly, the papers of the day were filled with other salacious stories, including the Massachusetts trial of Ferdinando Nicola Sacco and Bartolomeo Vanzetti,[193] and the discovery that eight members of the Chicago "Black Sox" baseball team had thrown the 1919 World Series.[194]

Almost a century later, Ponzi's name is used as shorthand to characterize all Peter–Paul schemes, though these schemes are generally small in size and scope. To even use the term to describe Madoff's scheme seems quite strange; BLMIS, a global investment fund with flashy investors and a revered Wall Street wizard as a manager, seems to be a different species than garden-variety Ponzi schemes. However, history has forgotten that Ponzi's own scheme was no garden-variety clandestine Peter–Paul scheme. It was a grand illusion conducted openly in all corners of Boston by a man who loved to talk to reporters and gained the support of police and bankers alike. If Madoff was an avuncular figure whose investments were safer than U.S. treasury bills to his clients, then Ponzi was a hero to his. Ponzi's fall from

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190. *See, e.g.*, Cunningham v. Brown, 265 U.S. 1, 11 (1924) (holding that investors that accepted Ponzi's offer to redeem their principal before maturity were subject to preference rules regarding clawbacks). *See also* ZUCKOFF, *supra* note 160, at 298 (explaining that for ten years the bankruptcy trustees sent small December payments to victims, refunding 37.5% of money invested to 20,000 people).

191. *See* ZUCKOFF, *supra* note 160, at 298 (noting that "a handful of Ponzi winners—those who'd collected their 50 percent interest before the collapse—turned over the money voluntarily").

192. *See* Gallagher v. Hannigan, 5 F.2d 171, 173 (1st Cir. 1925) (relating the facts of the bankrupt Old Colony Foreign Exchange Company, which had issued notes promising to pay fifty percent interest in ninety days beginning on July 23, 1920 and ending on August 13, after investors "started a run on" Old Colony after Ponzi's scheme was disclosed the day before). Two of the shareholders of Old Colony were arrested August 13, 1920, and the third left the country. *See id.*

193. *See* Commonwealth v. Sacco, 151 N.E. 839, 843, 845 (Mass. 1926) (describing the armed robbery of Slater & Morrill, Inc. and the shooting of two employees on April 15, 1920, and the 1921 trial).

194. *See generally* James R. Devine, *Baseball's Labor Wars in Historical Context: The 1919 Chicago White Sox as a Case-Study in Owner-Player Relations*, 5 MARQ. SPORTS L.J. 1 (1994).

grace was as dramatic as Madoff's, but history may not treat Madoff as benignly as it has treated Ponzi.

IV. CRIMINAL PUNISHMENTS AS REFLECTIONS OF SOCIETY'S FEAR AND OUTRAGE

Generally, the criminalization of an action, and the sentence that accompanies that action, reflects society's placement of a value on the liberty interest that is being violated by that action. If a society makes it a crime to physically assault another or to take another's life, then such laws reflect an individual's interest in bodily safety and an interest in being free from fear of bodily harm. From time to time, a particular society may choose to criminalize an act because of beliefs in the moral, not physical, harm of that act, such as adultery. Other laws may target acts that offend a society's moral sense but may also be framed as targeting acts that cause direct or indirect physical harm, such as prostitution. Over time, laws in a given society may change as groups of citizens persuade lawmakers that previous laws are obsolete or misguided. Whereas in one era the interest in not being cuckolded was exceptionally strong, not only for moral reasons but also for reasons of certainty in property distribution, this interest may not seem as strong in a different era. Therefore, state laws surrounding adultery may either be repealed[195] or not prosecuted.[196] In addition, citizens may persuade lawmakers to criminalize acts that have become a problem, either as behaviors change or technology enables new behaviors to be possible. For example, a state may create criminal prohibitions against certain types of activities that inflict emotional distress, such as stalking.[197]

Just as legal prohibitions of certain actions reflect society's values, the sentences given to criminals who violate these laws should reflect the priority given on the interests protected by the laws. Most states have a multitude of laws designed to ensure safe and orderly driving, and the violations of these laws carry varying punishments, from fines to jail sentences. These

195. *See* Gabrielle Viator, *The Validity of Criminal Adultery Prohibitions After* Lawrence v. Texas, 39 SUFFOLK U. L. REV. 837, 840-41 (2006) (discussing the rationale behind common law adultery prohibitions). For example, the District of Columbia abolished the criminal offense of adultery in 2004. *See id.* at 842.

196. Non-prosecution norms can lead to opportunities for selective prosecution by sending a message that the activity is not truly prohibited, but allowing law enforcement to retain the right to prosecute common acts. *See, e.g.*, Kay L. Levine, *The Intimacy Discount: Prosecutorial Discretion, Privacy, and Equality in the Statutory Rape Caseload*, 55 EMORY L.J. 691, 694 (2006) (outlining how "prosecutorial discretion works to control the reach of controversial criminal laws").

197. *See, e.g.*, TEX. PENAL CODE ANN. § 42.07(2) (Vernon 2003) (establishing the crime of stalking in which a defendant knows or reasonably believes that a course of conduct would, and reasonably does, put another in fear of bodily injury or death to herself or a household member or damage to property).

disparate punishments reflect the degree of seriousness with which the state views the acts, from jaywalking, to speeding, to driving under the influence of drugs or alcohol.

Unfortunately, as a society evolves and new crimes are continually added and few repealed, the end result may not seem consistent with modern values. Some laws currently in force may seem silly to modern citizens and may in reality not be prosecuted, or unfortunately, selectively prosecuted. In addition, the resulting array of punishments may not seem cohesive when certain crimes are compared to others. Even before the Madoff victims began telling their stories, other narratives were at work in enhancing the penalties for nonviolent thefts, in contrast to historical punishments for various categories of thievery.

A. Theft

1. *Common Law Theft*

Historically, society has had an interest in protecting the property rights of others, both in real and personal property. Theft laws reflect a society's valuation of ownership interests in personal property. At common law, the three main thefts were larceny, embezzlement, and false pretenses.[198] Though most state laws have collapsed these distinctions into one general theft statute,[199] at common law they were distinguishable and treated unequally. Larceny was defined as the wrongful taking of property from the victim's possession.[200] Larceny by trick expanded larceny to include situations in which the thief tricked the possessor into granting the thief possession, and then the thief effectively took title to the property.[201] Embezzlement applied to more complicated situations in which the thief was voluntarily given possession without any trick or evil intent, but then the thief wrongfully took title.[202] The crime of false pretenses covered situations where the thief was voluntarily given both possession and title to another's property, but under false pretenses.[203]

Larceny is the only adverse dispossession of these common law thefts, and was distinguishable because larceny threatened not only the bodily integrity of the possessor, but also the public peace. The society as a whole

198. *See* WAYNE R. LAFAVE, CRIMINAL LAW § 19.1 (4th ed. 2003) (chronicling the development of larceny in England and the subsequent creation of the crimes of embezzlement and false pretences for types of theft that fell outside the parameters of larceny).

199. MODEL PENAL CODE § 223.1(1) (Proposed Official Draft 1962).

200. *See* WAYNE R. LAFAVE & AUSTIN W. SCOTT, JR., HANDBOOK ON CRIMINAL LAW 622 (1972).

201. *See* LAFAVE, *supra* note 198, at § 19.1(b).

202. *See id.*

203. *See id.*

has an interest in having its public places free of both the violence of thievery and the violence of self-help remedies for thievery. As the crimes of embezzlement and false pretenses developed, however, courts took an interest in losses of property interest that were effectively peaceful but still created a need for deterrence and retribution.[204]

2. *Robbery*

Moreover, as crimes became codified, different types of thievery were also categorized based on interests other than personal property interests. For example, robbery occurs when possession is taken from the actual person of another, and it carries a higher penalty than some other types of theft.[205] This additional penalty reflects not the mere value of the owner's interest in the property, but also the value of the owner's interest in her bodily integrity.[206] During a forcible taking of property from one's person, the owner or possessor may be put in reasonable fear for her person. This interest in bodily integrity is an interest that society has historically held very dear, which explains why the United States has held its harshest punishments in reserve for actions that result in death or bodily injury.

In addition, unlike most larceny statutes, robbery statutes do not assign punishment based on the value of the property stolen. Rather, robbery statutes distinguish between the intensity of the fear that the victim may reasonably experience, based on whether the thief used a weapon or gave the impression that the thief had a weapon to use. Therefore, a robber faces the same penalty for stealing a wallet full of money or an empty wallet, but faces a harsher penalty if armed.[207] Again, the increased penalty reflects the increased value that society places on being free from fear of imminent severe physical harm.

3. *Burglary*

Just as having property taken off of one's person entails a different kind of risk of harm as property taken that was not in one's possession, property taken from one's home constitutes a separate violation. Burglary, the taking of a property from a residence, also carries a penalty greater than

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204. *See* George P. Fletcher, *The Metamorphosis of Larceny*, 89 HARV. L. REV. 469, 472-73 (1976).

205. *See, e.g.*, TEX. PENAL CODE ANN. § 29.02(a)(2) (Vernon 2003 & Supp. 2006). The crime of robbery under the Texas statute is a second-degree felony. *Id.* § 29.02(b).

206. *See* LAFAVE, *supra* note 198, at § 20.3 (describing robbery as an offense against a person and a substantial departure from societal norms).

207. *See, e.g.*, TEX. PENAL CODE ANN. § 29.03(a) (Vernon 2003 & Supp. 2006). Under the Texas statute, aggravated robbery is a felony in the first degree. *See id.*

simple theft.[208] Here, the crime reflects society's interest in both the sanctity of the home and the safety of one's self and family in one's home.[209] At common law, the elements of burglary also required that the taking occur after nightfall, possibly reflecting a concern that residents are more likely, though not necessarily, to be at home, and possibly asleep and vulnerable, after nightfall.[210]

B. Securities Fraud and Investment Fraud

If laws reflect the values of the society that enacts them, then criminal law in the United States tends to reflect a historical value on citizens' ownership interest in personal property; however, enhanced penalties for similar crimes that endanger life and limb seem to indicate an even greater value on bodily safety. In fact, the ultimate crime has been the taking of life, and the law reserves the harshest penalty, execution, for only certain categories of killings. However, recent changes to the Federal Sentencing Guidelines and recent sentences under those Guidelines seem to reflect a growing concern for financial safety, possibly over bodily safety. As the Madoff victim impact statements report, loss of financial safety can be a fate worse than death.[211]

V. FINANCIAL FRAUDSTERS AS THE NEW EVIL

Following the accounting scandals of 2001 and beyond, various corporate officers were prosecuted and convicted of fraud, often receiving lengthy sentences. Lawmakers and regulators spoke of restoring investor confidence in the markets so that investors felt sufficiently safe to invest their savings in U.S. securities. No longer were public officials worried about citizens feeling secure in their homes or even in actual physical marketplaces from bodily harm or fear of property theft; the larger concern was that

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208. *See, e.g.*, TEX. PENAL CODE ANN. § 30.02(a)(1) (Vernon 2003 & Supp. 2006). Under the Texas statute, the burglary of a habitation is a second-degree felony, but the burglary of a non-residential building is a state jail felony. *Id.* § 30.02(c).

209. *See* 4 WILLIAM BLACKSTONE, COMMENTARIES *223 ("[T]he law of England has so particular and tender a regard to the immunity of a man's house, that it styles it his castle, and will never suffer it to be violated with impunity . . . .").

210. Note that the residence need not be occupied at the time of the intrusion for the theft to be classified as burglary. MODEL PENAL CODE § 221.1(2) (Proposed Official Draft 1962).

211. *See* Victim Impact Statements, *supra* note 81, at 71, Email from Jackie Stone to Judge Chin (June 10, 2009) ("It was the beginning of a new kind of death–our family, including my dad, mom, brother, aunt, uncle, cousins–were ALL dead–in one shot. Bernie had killed our family, life, emotions, survival, resource for food, shelter, medicine and our belief in other humans. He DESTROYED our lives in one second!!!!!").

citizens felt secure in their savings.[212] If this confidence were not restored, then U.S. capital might shift to foreign investment or to less efficient uses. Just as larceny was a threat to the public peace, corporate fraud was seen as a threat to peaceful and efficient markets, which were essential to the U.S. economy.

In addition, corporate fraudsters incited the ire of the general public, and names like Bernard Ebbers and Jeffrey Skilling took the places of Jeffrey Dahmer and Ted Bundy as shorthand references to evil. Though prosecutors did not produce proof that Ebbers knew of accounting fraud at MCI WorldCom, Inc., in March 2005 the chief executive officer was found guilty of securities fraud under the theory of "willful blindness" and sentenced to twenty-five years in prison.[213] Jeffrey Skilling, former President and CEO of Enron Corp., was sentenced to twenty-four years in prison on charges of conspiracy to commit securities and wire fraud, multiple counts of securities fraud, false statements to auditors, and insider trading. Skilling faces a maximum prison term of 185 years if he is ultimately resentenced.[214] Charles Ponzi faced the wrath of both federal and state authorities, who even sought to jail him twice for the same crime, and served what seemed like a lengthy sentence—four of a five-year federal sentence and seven of a nine-year state sentence. However, his completely illegitimate fraudulent investment scheme earned him just a fraction of the jail time that federal judges have meted out to Ebbers, Skilling, and other convicted corporate officers.[215]

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212. Since the crash of 1929, regulators have stressed investor confidence. Ferdinand Pecora pontificated in 1934: "If the system of private property is to be a reality for all the people who save money as a protection against sickness and old age, there must be a discontinuance of past practices by which a few men have been able, for their own aggrandizement, to destroy the savings of hundreds of thousands—even millions—of our people." *See* ARVEDLUND, *supra* note 8, at 208.

213. United States v. Ebbers, 458 F.3d 110, 130 (2d Cir. 2006) (upholding sentence on appeal).

214. United States v. Skilling, 554 F.3d 529, 591 (5th Cir. 2009) (upholding conviction, but rejecting Guidelines enhancement for jeopardizing solvency of a financial institution, thereby vacating Skilling's sentence). Skilling has not yet been resentenced because his appeal of the Fifth Circuit's opinion regarding conviction was granted certiorari in the Supreme Court of the United States. *See* Skilling v. United States, 130 S. Ct. 393 (2009). Oral argument is set for March 1, 2010. *See* Supreme Court of the United States, *available at* http://www.supremecourt.gov/oral_arguments/daycall/daycall_03-01-10.pdf (last visited May 25, 2010).

215. Ken Lay, former CEO and Chairman of the Board of Enron, faced up to 165 years in prison, but died of a heart attack prior to sentencing. *See* United States v. Lay, 456 F. Supp. 2d 869, 875 (S.D. Tex. 2006) (noting that under existing law, Lay's conviction would be vacated due to his death prior to entry of judgment pending appeal). John and Timothy Rigas, controlling shareholders and corporate officers of Adelphia Communications Corporation, were sentenced to twelve and seventeen years in federal prison, respectively, from securities fraud violations. *See* United States v. Rigas, 584 F.3d 594, 601, 616 (3d Cir.

Between 1920 and 2009, several events have shaped corporate criminal law in the United States. Following the stock market crash of 1929, and the congressional investigations and hearings that followed, Congress built the foundation for the current securities law regime, enacting both the Securities Act of 1933 and the Securities Exchange Act of 1934 and creating the Securities Exchange Commission. Following the accounting scandals of 2001, Congress again addressed corporate officer behavior by enacting the Sarbanes–Oxley Act of 2002,[216] which among other things, required the Federal Sentencing Guidelines to be amended to impose harsher penalties on those who commit corporate wrongs.[217] Responding to public outrage over companies like Enron—whose stock price plummeted after revelations of corporate misdeeds and false disclosure, leaving employees and retirees with worthless 401(k) plans once bulging with company stock—the Guidelines were amended to reflect the importance of financial stability in large corporations, employee retirement plans, and financial institutions.[218] In upholding Ebbers' sentence, the Second Circuit acknowledged that: "Twenty-five years is a long sentence for a white collar crime, longer than the sentences routinely imposed by many states for violent crimes, including murder, or other serious crimes such as serial child molestation" and admitted that under the Federal Sentencing Guidelines "all but the most trivial frauds in publicly traded companies may trigger sentences amounting to life imprisonment."[219]

However, the court defended the "harsh, but not unreasonable" sentence by stating that "the Guidelines reflect Congress' judgment as to the appropriate national policy for such crimes."[220] Judge Chin also defended the 150-year sentence he fashioned for Bernie Madoff:

2009) (allowing prosecution in the Middle District of Pennsylvania to resume on some counts, even though defendants had already been convicted and sentenced in the Southern District of New York for similar crimes). Jamie Olis, a young, mid-level executive, became the poster child for excessive sentences when he was sentenced to twenty-four years for his alleged participation in accounting fraud at Dynegy, Inc.; on remand from the Fifth Circuit, his sentence was reduced to six years. United States v. Olis, No. H-03-217-01, 2006 WL 2716048, at *1 (S.D. Tex. Sept. 22, 2006).

216. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, & 29 U.S.C.).

217. Pursuant to sections 805, 905, and 1104, Congress requested the Commission to "promulgate the guidelines or amendments provided . . . as soon as practicable, and in any event not later than 180 days after [enactment]." *Id.* §§ 805(b), 905(c), 1104(c).

218. The Guidelines now provide for increases in penalties if the offense involves 250 victims, further increases if the offense substantially endangers the solvency or financial security of 100 or more individual victims, and further increases if the offense jeopardizes employee retirement plans. U.S. SENTENCING GUIDELINES MANUAL § 2B1.1(b)(13)(B) (2007).

219. United States v. Ebbers, 458 F.3d 110, 129 (2d Cir. 2006).

220. *Id.* at 129-30.

> Here, the message must be sent that Mr. Madoff's crimes were extraordinarily evil, and that this kind of irresponsible manipulation of the system is not merely a bloodless financial crime that takes place just on paper, but that it is instead, as we have heard, one that takes a staggering human toll.[221]

The prosecution, in preparing its Sentencing Memorandum that proposed a sentence of 150 years, calculated this amount according to post-2002 Guideline enhancements for losses of more than $400 million, harm to more than 250 victims, and harm that endangered the financial security of 100 or more individuals.[222]

CONCLUSION

Though historically one's home has been one's castle and worthy of heightened protection from the law, the past decades of relative peace in the United States have mitigated our concerns of home invasion and other types of criminal physical harm. However, one's savings and retirement accounts have become the new castles that must be protected by the government from criminal fraudsters. As daily survival has become expected and our life expectancy extended, our fears have shifted to survival of our retirement funds. Narratives of those who have lost their nest-eggs, whether Enron employees or Madoff victims, resonate with the populace and with legislators. Amendments to the Federal Sentencing Guidelines reflect these new fears, and corporate officers like Ebbers and Skilling, and fraudsters like Madoff, feel the wrath of those harmed in their lengthy sentences. Rightly or wrongly, the Madoff victims equate their financial ordeal with the most violent atrocities in human history. Perhaps Judge Chin's wish that Madoff's lengthy sentence have symbolic meaning is fulfilled; however, the sentence may symbolize the greed of the victims as well as the greed of the fraudster.

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221. Sentencing Transcript, supra note 5, at 47.
222. *See* Sentencing Memorandum, *supra* note 30, at 16-17.