Unwinding the biggest Ponzi scheme in U.S. history hasn’t been cheap. Six years after Bernard Madoff’s fraud collapsed, the cost of liquidating his defunct investment advisory firm to repay thousands of victims has topped $1 billion, though the con man’s former customers aren’t footing the bill. The fees, paid by the industry-backed Securities Investor Protection Corp., or SIPC, which is managing the case, have financed a team of lawyers who...
Extraterritorial limits of the long arm of US bankruptcy law

By: Jason Kilborn

The international reach of U.S. bankruptcy law might well be regarded as imperialistic. As to any debtor who satisfies the broad eligibility qualifications, a U.S. bankruptcy proceeding encompasses all rights in property of the debtor, “wherever located and by whomever held.”

The historical record confirms that Congress intended the “wherever” here to extend around the world. But in one important respect, this world domination is limited, as a New York court confirmed recently. Foreign investors receiving fund transfers to non-U.S. accounts, take note!

A non-U.S. transferee might understandably resent and resist demands under U.S. law by a U.S. trustee to turn over assets related to a U.S. bankruptcy case, especially if the transferee was unaware of any U.S. connection.

For example, if the debtor had transferred funds to a foreign bank, which in turn transferred the funds on to the non-U.S. party, it may well be entirely unclear to the ultimate recipient that the funds originated from a U.S. entity. Even if the U.S. source of the funds were apparent, if the transaction was predominantly centered outside the U.S., what legitimate business does U.S. law have meddling in foreign affairs?

Let it not be said that U.S. law is insensitive to these concerns, as a powerful pair of jurisprudential limitations protect non-U.S. transferees in such circumstances. A high-profile example of the problem and the limitations appeared in the landmark cross-border bankruptcy of Maxwell Communication Corporation plc in the 1990s. In light of its broad international footprint, Maxwell initiated Chapter 11 proceedings in New York along with administration proceedings in London.

Shortly before its insolvency filings, Maxwell had sold significant portions of its U.S. assets, and it subsequently transferred more than US$100 million of the proceeds to pay down overdraft balances on London bank accounts owed to British and French banks. The case administrators ultimately sought to recover and redistribute that money as preferential pre-petition transfers, and since English insolvency law was too restrictive to enable a recovery, they enlisted the aid of the U.S. court.

While recovery of transfers like these is otherwise commonplace in U.S. bankruptcy cases, the New York bankruptcy court refused to apply the U.S. claw-back law, even though that would deprive Maxwell’s creditors of a large benefit.2 The New York court based its decision on two related limitations on the extraterritorial reach of U.S. law.

First, under longstanding doctrine, U.S. law is presumed not to apply outside the territorial limits of the U.S. unless Congress clearly intended an extraterritorial reach. Congress might choose to allow U.S. law to apply abroad, as in the statute mentioned above defining the worldwide scope of the bankruptcy estate, but that intention must be clear from the statute or its history. In the case of the provisions on avoidance of pre-petition transfers, no such intention is clearly reflected in the legislative record.
Of course, not every application of U.S. law that affects a non-U.S. party can be properly characterized as “extraterritorial.” The court set up a “center of gravity” test for examining the “component events” of the transfer, such as the location of the transferee and transferor, the source of the funds transferred, and the motivation for and location of the transfer.

Although the US$100 million originated from sales of U.S. assets, and the debtor was soon to be involved in a U.S. bankruptcy case in which the recipient banks were making claims, Maxwell was an English corporation, the overdraft debts had been incurred in London, the transfers were made in London or, at least, used to satisfy debts located in London, and though the recipient banks had New York branches (one of which was even used to route the U.S. dollar denominated payments), they were British or French companies. The center of gravity of the transfers, then, was outside the U.S., and since the presumption against extraterritoriality had not been rebutted, U.S. law could not reach these transfers.

Second, and on a related note, the New York court refused to apply U.S. law out of deference to and to avoid conflict with the nation whose laws more appropriately applied here: England. The longstanding choice-of-law doctrine of international comity compelled the court to cede to the law of the jurisdiction having the greatest interest in the disputed event. Returning to the “component events” and their national contact points here, the court concluded again that England had the dominant interest in the transfers and parties in this dispute, and so U.S. law should yield to English law in any event.

A similar battle played out just a few months ago, and the New York court confirmed that its approach remains the same. As part of his efforts to deal with the detritus of the Madoff investment fraud scheme, the trustee of Madoff’s failed firm sought to recover payments that had ultimately made their way to non-U.S. investors.

The Madoff firm made the payments originally to its clients, non-U.S. feeder funds, who then transferred the funds on to the funds’ investors. U.S. law provided for recovery from such twice-removed transferee-investors, and these investors were well aware that the funds represented investment returns from a U.S. entity. It seemed eminently sensible for U.S. bankruptcy law to ratably redistribute the gains from these investors in order to more thinly spread the pain of loss among the many Madoff victims.

The New York district court on July 6, 2014,3 once again rebuffed this attempt to recover payments from non-U.S. recipients, invoking the presumption against extraterritoriality under circumstances very similar to those in the Maxwell case 20 years earlier. For reasons again similar to those in the Maxwell case, the Madoff court also noted the doctrine of international comity as an additional and independent basis for its decision, as the center of gravity of these payments was rather clearly not in the U.S. The Madoff feeder funds were BVI (Fairfield Sentry) or Cayman (Harley Int’l) entities, the investors who received the transfers were likewise non-U.S. entities, and the transferor and recipient accounts were all outside the U.S.

Unlike in the Maxwell case, the transfers from the feeder funds to the investors did not even originate in the U.S. The known U.S. original source of these funds was too slender a lever to shift the center of gravity of these transfers into the U.S. And with a non-U.S. concentration of parties and events, international comity dictated in any event that these transfers could only appropriately be governed by BVI, Cayman, or other non-U.S. law, especially since liquidation proceedings had already been commenced against the feeder fund-transferors in their home jurisdictions.
Almost six years after Bernie Madoff admitted his investment firm was based on “one big lie,” two European criminal cases linked to the convicted fraudster are working their way to trial in Geneva.

Prosecutor Marc Tappolet is finishing an indictment of five managers at Aurelia Finance SA after the final pre-trial hearing wrapped up, said Henri Della Casa, a spokesman for the Geneva prosecutor’s office. One more witness needs to be questioned in another country before a second case can proceed against the former head of Banco Santander SA (SAN)’s Optimal Investments unit, he said.

Aurelia was one of dozens of European vehicles that were known as “feeder funds” because they pooled assets to invest with Madoff.

“The Aurelia criminal trial is of great importance as it’s the first time managers of a so-called Madoff feeder fund are being held accountable for their alleged misconduct at a European criminal court,” said Erik Bomans, a partner with Deminor Group, a Brussels-based adviser that represents about 4,000 Madoff investors. “It will be a first important test for investor protection over the Madoff fallout in Europe.”

Madoff, 76, is serving a 150-year prison sentence in the U.S. after pleading guilty in 2009 to running a $17.5 billion Ponzi scheme that took money from new investors to pay old ones. A U.S. federal jury in March found five members of Madoff’s inner circle guilty of securities fraud, in what was likely the only criminal trial linked to the fraud anywhere in the world. Sentencing of the group was postponed until December as lawyers argued over financial penalties.

**Aggravated Mismanagement**

The five Aurelia managers were charged with “aggravated mismanagement” of clients’ money in April 2009, Tappolet said when he began his pre-trial investigation. The term typically means mismanagement with the intent of profiting from the act.

Albert Righini, a lawyer for Pascal Cattaneo, one of the Aurelia executives, declined to comment on any trial, which probably wouldn’t be scheduled before next year. Gerhard Auer, the Geneva-based administrator liquidating Aurelia Finance’s assets, said that the company has had no civil proceedings pending against it and declined to comment on the criminal case.

Francois Canonica, one of a team of lawyers who represent 75 investors who invested about 60 million Swiss francs with Madoff through Aurelia, said his clients were cheated by fund managers who didn’t sufficiently diversify their investments and were overly trusting of the New Yorker.

“The traditional rules by which fund managers are obliged to diversify investments were gravely violated,” he said in an interview.

Canonica has said his clients have received nothing while other Geneva investment firms that invested with Madoff have been offered compensation. Notz Stucki & Cie in 2009 pledged to return as much as 120 million Swiss francs to customers and Union Bancaire Privee about $700 million the same year.

They are among at least seven firms in the region that lost as much as $7 billion in the fraudulent scheme that cost investors worldwide about $65 billion.

Charles Poncelet, who represented the Aurelia executives when the charges were filed in 2009 and has since stepped back from the case, said the case is without merit.

“This is a ridiculous case brought by an overeager prosecutor who thinks that making a bad investment
can be a crime,” he said in an interview.
Irving Picard, the trustee liquidating Bernard L. Madoff Investment Securities LLC, has recovered more than $9.8 billion, or 56 percent, of the $17 billion in claims, and distributed almost $6 billion of that. Picard is holding back about $4.3 billion because of ongoing appeals and related disputes.

**Geneva Reputation**

Madoff’s deception was a blow to Geneva’s reputation as a safe place to do business and the trials are an unwelcome reminder at a time when the city’s financial community has other challenges. The fraud “was a shock as Geneva is very much old money, so credibility and prestige are very important,” said Stephane Garelli, a professor at IMD business school in Lausanne, Switzerland. “It was a bad moment for a lot of people in Geneva because they didn’t show very good judgment -- and today people will say ‘let’s turn the page, let’s forget about that, we have enough on our plate in future with banking secrecy and other things.’”

**U.K. Unit**

While victims of the fraud were spread across Europe, Tappolet is the only public official who has been willing to file a case. The U.K. Serious Fraud Office in 2010 said there was insufficient evidence to bring charges against Madoff’s U.K. unit, where U.S. prosecutors said he transferred more than $250 million.

Manuel Echevarria, the former head of Santander’s Optimal Investment unit, was charged in 2009 with criminal mismanagement over his handling of client funds. Optimal had about 2.33 billion euros ($2.9 billion) invested with Madoff at its peak.

Saverio Lembo, a lawyer for Echevarria, declined to comment on the case beyond saying that his client “is strongly determined to prove his innocence.”

Six years on, Tappolet will face a challenge in securing a guilty verdict, said Luc Thevenoz, a professor of law and director of the University of Geneva’s Centre for Banking and Financial Law.

“It will be very difficult to convince a court that there was criminal intent and that the defendants were aware of Madoff’s fraud,” he said.

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**Herald Fund SPC (In Official Liquidation) Announces**

**GEORGE TOWN,** Cayman Islands, Nov. 17, 2014 /PRNewswire/ -- Russell Smith and Niall Goodsin-Cullen of BDO CRI (Cayman) Ltd., the Principal Liquidators of Herald Fund SPC (In Official Liquidation) ("Herald"), are delighted to announce the achievement of a global settlement agreement with Irving H. Picard, Trustee for the Estate of Bernard L. Madoff Investment Securities LLC ("Trustee") which is considered to be very beneficial to Herald’s stakeholders. The Principal Liquidators were assisted by their US and Cayman Islands legal counsel (respectively, Kirkland & Ellis LLP: led by partners Joseph Serino and David Flugman; and Walkers: led by partner Matthew Goucke).

The settlement agreement, which was made public today in New York through a filing with the U.S. Bankruptcy Court for the Southern District of New York, achieves an allowed customer claim for Herald in the BLMIS estate in the amount of approximately $1.64 billion free of any subordination or holdback and a full resolution of the Trustee's clawback claims against Herald, originally asserted in the amount of $578 million. Herald's shareholders will not be required to enter into any due diligence procedures with the Trustee in order to be eligible for distributions in Herald's liquidation. Under the terms of the settlement, Herald will receive a credit of $100 million against its clawback liability in connection with a payment made earlier this year by JPMorgan, part of which was in satisfaction of clawback claims asserted against JPMorgan in its capacity as a Herald shareholder. Applying this credit, and other credits of $10 million, to the amount of the withdrawals made by Herald through its Luxembourg-based custodian, HSBC Securities Services (Luxembourg) S.A. ("HSSL"), Herald has agreed to pay the Trustee $467,701,943 in full satisfaction of the Trustee's claims against Herald.

Herald's customer claim will be allowed in the
week surpassed $10 billion in recoveries for victims, or almost 60 percent of the principal that vanished after Madoff’s arrest in December 2008. “No one would have anticipated this recovery six years ago, and not a nickel of the fees has come out of the customer fund,” Stephen Harbeck, SIPC’s president, said today in a phone interview. “It’s a remarkable achievement.”

Irving Picard, the bankruptcy lawyer who’s leading the effort as trustee for Madoff’s company, included the new fee total in an interim report posted yesterday on his website. A bankruptcy judge in Manhattan regularly approves the fees, sometimes over the objections of victims’ groups. The victims, who lost $17.5 billion in principal, have been paid back almost $6 billion by Picard since he started distributing the recovered funds. Billions more are being held in reserve until lawsuits by victims seeking larger payouts are resolved. The last distribution, about $349 million, was in May.

1960s Origins

The fraud, which prosecutors said started as early as the 1960s, involved millions of pages of fake trades and account documents that were used to convince customers they owned securities in the biggest U.S. companies. Their final account statements included about $47 billion in fake profit.

Picard, hired by SIPC days after Madoff’s arrest, has used hundreds of lawyers, forensic accountants and

SOURCE BDO CRI Ltd.

Recoveries, Distributions and SIPC Commitment

The amount of $1,639,896,943, calculated by adding 100% of the agreed clawback liability onto the $1,172,195,000 net loss of invested principal suffered by Herald’s investors in the Madoff fraud. This marks the first time in several years that the Trustee has agreed to a full 100% springing claim in a settlement. Herald will be entitled to a catch-up distribution on its allowed customer claim of $755 million and the parties have agreed to deduct the full amount of Herald’s clawback liability from this catch-up distribution. After subtracting $29 million which Herald is temporarily advancing on behalf of its largest investor, Primeo Fund (In Official Liquidation) (“Primeo”), to satisfy Primeo’s own clawback liability, the Principal Liquidators expect to receive approximately $260 million in cash in early January 2015.

Assuming a 75% total recovery on Madoff customer claims, Herald expects to receive approximately $500 million in addition to the money it will receive in catch-up distributions, bringing its ultimate total recovery under this settlement to $760 million in unencumbered cash available to distribute to its investors. This amount does not include the $13-$15 million that Herald expects to receive from the JPMorgan class action settlement, nor does it include the value of Herald’s ongoing claim against HSSL in the Luxembourg Courts as well as other potential claims.

Herald will receive a full release from the Trustee and Herald’s shareholders will receive a release from any claim that the Trustee may have in connection with those shareholders investments in, or withdrawals from, Herald.

The settlement remains subject to approval by the Grand Court of the Cayman Islands and by the Bankruptcy Court in New York, which hearings have been scheduled to take place before the end of 2014.

The Principal Liquidators consider this to be an excellent result for the Herald’s stakeholders and one which has been achieved expeditiously given that Herald’s liquidation commenced in July 2013.

SOURCE BDO CRI Ltd.
other professionals to unravel the swindle and determine who held valid claims -- those who deposited more money than they took out -- and who needed to be sued for profiting from the scam.

“Our investigations, dissection and reconstruction of the fraud have proven invaluable in identifying how the Madoff Ponzi scheme began and lasted as long as it did,” David Sheehan, the trustee’s lead lawyer, said in an e-mail.

Picard, of Baker & Hostetler LLP in New York, recouped the cash through hundreds of lawsuits and settlements with Madoff’s customers and banks that benefited from the scheme, even if they weren’t aware of it.

Supreme Court

Many of the cases have triggered appeals, some to the U.S. Supreme Court, raising the cost of liquidation. One of the biggest disputes was over whether Picard was to set claims based on principal and not so-called fake profits, an argument he won. Outstanding disputes include whether Madoff’s earliest customers should be able to seek interest on the principal they invested with him decades ago.

The legal team passed the $10 billion recovery mark on Nov. 17 after reaching a deal with two funds that funneled money to the fraud, Primeo Fund and Herald Fund, both based in the Cayman Islands. The funds agreed to pay a total of $497 million to end lawsuits over their withdrawals from Madoff’s firm.

The trustee has also sued dozens of individual customers who withdrew more money from their accounts than they deposited, to repay net losers. Madoff’s lifelong friend Edward Blumenfeld, a New York real estate developer who built a fortune by investing with the con man for decades, agreed to a settlement worth $62 million to end the lawsuit against him -- a deal approved by the court Nov. 18.

Continued on 8
**Updated Claims Total.** Perhaps not surprisingly due to the complex documentation that many claimants needed to assemble, many claims were filed at the very last moment. As a result, an avalanche of mail containing claims postmarked in the days or hours before the claims deadline continued to arrive at MVF for several weeks after the deadline. As a result, MVF ended up with a total of 63,553 claims covering losses of $76.654 billion. Of the total, 21,822 claims are from U.S. residents, while 41,731 claims are from foreign nationals. The last minute surge in claims nearly doubled the aggregate dollar value of claimed net investment losses MVF had previously received.

U.S. residents filed claims covering $30.7 billion in investment losses, while foreign nationals submitted claims covering losses of just under $46 billion. It is important to note that these numbers are "raw" data, or exactly what arrived in the mail. Once MVF reviews the raw data, the number and dollar value of claims will decline as ineligible and duplicate claims are weeded out, and as overstated claims are reduced in size. Nonetheless, the surge of claims at the end of the filing period reinforced the fact that the crimes committed at Madoff Securities caused historically unprecedented losses to individuals around the world.

**Recent Activities.** Prior to the claims deadline, most of MVF's focus was on helping individuals understand the claims process and what records they needed to file. With the expiration of the filing period, MVF's efforts have shifted to the much more difficult process of evaluating which claims are potentially eligible, and in what amounts. Ultimately MVF has to be able to recommend final action to the Department of Justice on all 63,553 claims.

MVF's initial work was to scan every claim and enter all of its data into our claims database. Over 3.3 million pages of documents, most of which were not previously submitted in the bankruptcy proceedings, were assembled into a comprehensive database. As a result, by mid-summer MVF's staff have been engaged entirely in reviewing the specifics of claims. The detailed review of each claim often occurs through multiple stages. Among other things, MVF must verify the identity of the claimant and the claimant's eligibility to recover under MVF's standards, the adequacy of documentation of the claimed losses, what percentage of the claimed losses were actually invested in Madoff Securities, whether the claimant was the "ultimate investor" or only an intermediary, and how much a claimant may have recovered from other sources. That work is critical to making it possible for victims to receive the largest possible payout, without dilution from overstated or ineligible claims.

The trustee has said his goal is to return 100 percent or more of the $17.5 billion in lost principal. “It’s obscene,” Helen Davis Chaitman, a lawyer representing some victims in the case, said in an e-mail about the fees. Most of the money was recovered through the work of prosecutors, and Picard “has taken credit for this.” Chaitman has argued in court that Picard should have set victims’ claims based on their final account statements, including fake profit, rather than the money they deposited minus the money they took out. Judges rejected that view. SIPC closely scrutinizes the fees it pays, and backs Picard's view that all customers should have their principal returned before any fake profit is paid out, Harbeck said.

**Madoff Prison**

Madoff, 76, pleaded guilty to fraud in 2009 and is serving a 150-year sentence at a federal prison in North Carolina. At least seven other people have pleaded guilty to roles in the scheme, including his brother Peter Madoff, who is serving a 10-year term. A federal jury in Manhattan in March found five former Madoff employees guilty of aiding his fraud for decades by creating fake trading documents and account statements. They were accused of targeting thousands of retirees, wealthy investors, charities and even family and friends, and getting rich in the process. The five ex-workers are scheduled to be sentenced next month.
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