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# Ire at Madoff Swings Toward the Referee

The victims of Bernard L. Madoff, who was sentenced to 150 years in prison on Monday for his heinous financial crimes, deserve our sympathies. Given where this column is headed, I should probably make that point right up front.

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TALKING BUSINESS

You can say, as I have previously, that they ought to have seen all the red flags, starting with his too-steady-to-be-true returns. But would you have seen them? This was a classic "affinity fraud": Many of Mr. Madoff's investors were elderly Jews, who put their trust in "one of their own." Every month, they received statements that looked a lot like a typical brokerage statement — with lists of Fortune 500 stocks and plain vanilla bonds that they supposedly owned (though, of course, they didn't).

And ever since Mr. Madoff's Ponzi scheme was revealed, the victims' lives have taken heartbreaking turns. Cancer patients who can no longer afford their treatments. People whose retirements have been destroyed. Elderly parents who have had to move in with their children. I read this week about a family that took out a $100,000 home equity loan and invested it with Mr. Madoff, betting that the can't-miss returns would help pay for their sons' college education. Now, they not only can't afford the tuition, but are $100,000 in debt.

The day after the Madoff sentencing, I attended a meeting of victims at a Manhattan synagogue. I thought there would be at least some joy over the fact that their nemesis was going to spend the rest of his life in prison. But there was none. Instead, there was anxiety.

The crowd was elderly and, by the looks of things, far from wealthy. A deadline was looming for them to file claims to the trustee of the Madoff bankruptcy to be eligible for up to $500,000 in funds from the Securities Investor Protection Corporation. Many had not yet filed. A panel of tax and accounting experts had assembled to answer their questions. Most of the questions expressed fear — fear that the trustee, Irving H. Picard, would try to claw back money they had withdrawn over the years from their accounts, or that they wouldn't be eligible for SIPC aid. Mainly, they seemed traumatized.

What I also heard that night, though, was a different, and altogether less sympathetic, feeling of victimization. Ever since the scandal broke, many victims have felt aggrieved at the bankruptcy process itself, some feeling that Mr. Picard and SIPC have treated them almost as badly as Mr. Madoff had.

Brian Neville, one of the expert lawyers at the meeting, has filed a class-action lawsuit against Mr. Picard, in an attempt to get some Madoff victims more money. Others feel wronged because Mr. Picard is refusing to award any SIPC money to investors who took out more from their Madoff account than they put in. The so-called indirects — people who invested with Mr. Madoff via a feeder fund — aren't eligible for any help from the trustee. (Their only recourse is to sue the feeder funds — though Mr. Picard is also trying to reclaim money from the feeder funds.) So of course they're upset. And everybody is mad that Mr. Picard is demanding they give back any money that was withdrawn in the 90 days before the Ponzi scheme was exposed.

Now that Mr. Madoff is in prison for good, this is where the anger of the victims has turned — toward those with their hands on the purse strings, starting with Mr. Picard. But while that anger may be understandable, it's not remotely justified.

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Put yourself, for a moment, in the shoes of a certain class of Madoff victim — what the trustee is calling "net winners." These are the people who took out more money from their accounts than they put in. I'm not talking about the likes of Jeffry M. Picower, who withdrew a staggering $5 billion more than he put in — and whom Mr. Picard is suing to get that money back. I'm talking about the Madoff investor who put in, say, $1 million and over a 15-year period withdrew $1.2 million.

On that person's November 2008 statement — the last one before the fraud was exposed — she probably still had a very healthy balance, maybe $500,000 or more. It's only natural that she views that balance as money that was hers — but that

***The victims exclaim they feel cheated anew, this time by the process.***

she has now sadly lost. To her, that money is real.

Now look at that same net winner from Mr. Picard's point of view. In truth, that $500,000 doesn't exist. After all, Mr. Madoff wasn't really running an investment fund; he was running a Ponzi scheme. The steady returns, from which that $500,000 was supposedly generated, were fictitious.

"What they were getting was other people's money," said David J. Sheehan, a lawyer at Mr. Picard's firm, Baker Hostetler. In other words, any money our hypothetical Madoff investor received came from the pockets of other Madoff investors, who were putting money into their accounts. That's how Ponzi schemes work. And because that $500,000 never really existed, Mr. Picard has said he will not count it. He is going to count only how much actual money went into an account versus how much came out.

I can't see how anything else is fair. Mr. Picard's approach means that the investors who will receive at least something back from the Madoff estate are the "net losers" — the ones who aren't saddled with just hypothetical losses, but with real losses from having put in more money than they took out. Besides, isn't there something just a little insane about basing recompense on statements ginned up by a crook?

Yet Mr. Neville, the lawyer at the victims' meeting I attended, is suing Mr. Picard, claiming that his refusal to accept the Madoff statements at face value is a misreading of the law. (It almost certainly is not.) More surprising yet, many of the more vocal activists among the Madoff victims have taken up this rallying cry. The idea that Mr. Picard is doing them wrong by using his money-in-money-out standard has become conventional wisdom, even though the approach they prefer will hurt precisely those Madoff victims who have come out of this tragedy the worst off financially.

"We want the trustee to use the correct definition of 'net equity,' " said Ron Stein, one of the organizers of the meeting of victims. ("Net equity" is the legal term for how the trustee calculates a claim.) The fact that this would mean less money for the net losers was never mentioned.

And so it goes. Why is Mr. Picard deducting money taken out in the last 90 days? It is not to unduly punish Madoff victims. It is because those are the rules of bankruptcy: anyone who has been paid anything within 90 days of a bankruptcy has to return the money. Why isn't Mr. Picard just giving everyone who was a Madoff victim a "free" $500,000 from SIPC? Because SIPC is not insurance so much as it is an advance against a final accounting once Mr. Picard has collected everything he can from the Madoff estate. The "indirects" aren't eligible for help from the Madoff trustee because they weren't Madoff clients, the feeder funds were. It's all pretty basic, and hard to argue with — unless, that is, you're a Madoff victim.

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Here's the unspoken truth about this case: The victims of Mr. Madoff's fraud are being treated far better than most people who invest in Ponzi schemes. The Internal Revenue Service has given Madoff investors tax breaks that other Ponzi scheme victims could only dream of. The Securities and Exchange Commission, embarrassed at its failure to catch Mr. Madoff, has quietly proposed ways to get more money to Madoff victims. Mr. Picard has allowed Madoff victims to claim special hardships to get them their SIPC money more quickly.

***The anger belongs at the feet of one man, who is now in prison.***

Most crucially, the law says that Mr. Picard is supposed to try to claw back money from the net winners — again because that is money that came from the pockets of other investors. Usually, that is exactly what a trustee does in this situation, regardless of how much pain it inflicts on innocent people.

But in this case, Mr. Picard is acting more gingerly. He is going after Mr. Picower and a handful of others he believes knew about Mr. Madoff's scheme (they deny it, of course). But he has also said publicly that he is not going to try to claw back money from people who have little means to pay it back, or whose net winnings are small.

Does this mean he will avoid inflicting pain on innocent people? Of course not. There will undoubtedly be clawbacks from people who, say, inherited their Madoff account and had no idea they were big net winners. The outcry from the Madoff victims, as they receive less from SIPC than they had hoped, or find themselves ineligible for any recovery, suggests that there is already a lot of pain.

But the essential unfairness is Mr. Madoff's fault, not Mr. Picard's. He has been left with a series of unpalatable choices, and it seems to me he is trying to deal with them in as fair a manner as possible. Every time he decides not to try to claw back money from that cancer patient who can't afford treatment, he is depriving some other Madoff investor of money that belongs to him. No matter what he does, someone gets hurt.

"We're not heartless," Mr. Sheehan said. But try telling that to Mr. Madoff's former investors. On Monday, after Mr. Madoff was sentenced, I heard a victim interviewed on television. Now that the crimes of Mr. Madoff have been dealt with, she said, "we need to turn our attention to the crimes of Mr. Picard and SIPC."

You know what they say. No good deed goes unpunished.