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**Greater and Lesser Potpourri Regarding Madoff,
Starting with the IRS
and Then Moving to Other Matters - Part 2
National Affairs**

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The SEC - though it ironically is one of the governmental or quasigovernmental bodies most responsible for allowing Madoff to succeed - has put together what one thinks the best description to date of the methods used by Madoff to fool victims, agencies, feeder funds, and huge organizations or immensely wealthy individuals who sought to do due diligence, and others. The description, which I think one Madoff victim said (correctly) is very well written, appears in the SEC's August 11th complaint against DiPascali. (The description in the U.S. Attorney's "Information" is not as good, in my judgment.)

As the SEC's complaint makes clear, Madoff and DiPascali did almost anything you can think of to fool people. False statements spit out by the infamous 17th floor computer, a hoked up phony computer system that made it seem like the Depository Trust Company held securities for Madoff's investment business, telling American questioners that Madoff's counterparties were European and telling European questioners that the counterparties were American because in each case this would make the questioners less likely to check with possible counterparties, refusing to give the names of claimed counterparties, hoking up extra trades at the end of the year for investors who were to receive more than others (doubtlessly co-participants, I think, in what they at least knew to be a fraud even if they did not know that the exact nature of the fraud was that it was a Ponzi scheme), purporting to make trades over several days rather than on one day alone when the amount purportedly traded would be so large as to arouse suspicion if the trades all took place on one day, making sure that claimed prices on a given day were within the actual price band on that day and claiming his statements showed an *average* price when this was necessary to avoid suspicion, refusing to describe his alleged methodology on the ground that it was proprietary, using only large cap stocks so that the trading volume in the market would be large enough that people wouldn't question whether he had in fact made trades, creating special accounts for the purpose of fooling the SEC, claiming that securities were held by European financial institutions, creating false records of supposed trading - Madoff and DiPascali did all these things. You name it, they did it.

We may hear a lot more about all this in future, because Madoff's and DiPascali's extraordinary, shrewd (and usually successful) efforts to hide their fraud are likely to come up by way of attempted defense in the hosts of lawsuits that will be brought against the SEC, FINRA (which so far, with but one exception that I know of, has received a free pass that is exceedingly unlikely to be permanent), the IRS, feeder funds that failed to do adequate due diligence, and others.

Of course, Madoff did *not* fool everyone who looked into what he was doing. Markopolos was not the only one who suspected fraud. There were large institutions and very wealthy people who looked into Madoff (or who because of their enormous wealth heard the word on Wall Street) and decided they wanted no part of this guy. There also were huge investment banking houses - Goldman, Sachs, for example - that refused to do business with him because they did not believe he could be for real. One lawsuit even alleges that, as of sometime in 2008, Madoff's main bank, J.P. Morgan Chase, *knew* he was a fraud - and consequently pulled out 250 million dollars from a Madoff fund even though Madoff was the only investment that wasn't losing money.

The institutions and the wealthy - who hired experts in due diligence - that were wary of Madoff had several reasons, many of which have now been widely bruited, e.g., that he used a one man accounting shop, his refusal to discuss his investment strategy, the family nature of his business, the inability of experts to replicate his results, etc. All of these things *should* have been, in Markopolos' words, red flags to *all* sophisticated, major institutions, feeder funds, due diligence experts working for wealthy individuals, and governmental and quasigovernmental bodies. But there were two things that government (and others as far as I know) *should* have done, but did not do, that would have blown the whistle on Madoff despite all his efforts at concealment and trickery. That government, and others who were expert, did not do these very simple things is inconceivable to me. They also seem to me to be of increasing importance as we learn more about Madoff's vast efforts at concealment, because they are things that Madoff could not have controlled, could not have faked his way past, though they are quintessentially simple, and would only have required a few phone calls to initially carry out.

First, Madoff claimed that he bought and sold securities about four times a year and was in Treasuries. Many of the securities were supposedly held by the Depository Trust Company, which, as I understand it, performs this function for most or all of Wall Street. All that the SEC, the IRS or FINRA had to do was to get in touch with the DTC and inquire whether its records showed that Madoff heavily bought securities - billions of dollars worth of them - four times a year, held them for awhile, and then sold them (and replaced them for a period with Treasuries, if the Treasuries too were held by DTC, which I do not know). By this simple means, by the proverbial means of a phone call, the government would have found out that Madoff had been doing no such thing, and his fraud would have been exposed.

I believe I am correct in thinking that, ever since the Billy Sol Estes scandal, auditors have been required to check whether assets, goods, etc. that a company claims to have do in fact exist. No more empty tanks, please. But here the government did not do this elementary auditing check - it did not even ask the purported holder of securities whether it *had* held the securities. Is it humanly possible to have been more negligent, more incompetent, than that?

You know, I'll bet that most Madoff victims did not even know that there *is* a Depository Trust Company or what it does. I know I certainly didn't. Most of us, after all, know very little about how Wall Street works as a "logistical" matter. We wouldn't have known to make inquiries of DTC - which perhaps would not have answered our inquiries had we made them - even if we had suspicions about Madoff, which we didn't. But the regulators, on whom we depended, surely knew about DTC and what it did, and DTC surely would have or could have been compelled to answer their questions. Yet the regulators did not even pick up the phone to call DTC.

The second matter is likewise pretty simple. Madoff claimed to be hedging with put and call options. Without these options his strategy made no sense. With them it made all the sense in the world (some of us think). But it turns out that apparently there were not enough put and call options or put and call option traders in the world, literally in the world, to hedge the amounts of S&P 100 securities that Madoff claimed to be dealing in.

Had the regulators so much as made a few phone calls, they would have learned this, and would have learned as well that *nobody* appeared to be dealing with Madoff with respect to *any* options. Some calls to the Chicago Board of Options Exchange would have elicited that nobody there was doing any options business with Madoff. Ditto if the regulators had made some calls to over the counter traders in options or to European institutions that might deal in options (and that Madoff was falsely telling people he used). Finding out that nobody said they were dealing in options with Madoff would have set the stage for regulators to compulsorily demand, by subpoena, that Madoff tell them whom he was buying options from and selling them to, so that his claim of trading options could be checked out with the supposed counterparties. But none of this was done, although it would only have taken some phone calls and ultimately drafting a subpoena - and, in the words of Michael Bienes about making money via shilling for Madoff, would have been easy-peasy. Here again, then, the incompetence, negligence and plain laziness of the regulators beggars the imagination.

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A last point for today:

The lawsuits are already flying and there will be lots more of them. In the course of some of them, defendants will claim that they can have no liability to plaintiffs because they weren't doing business with them, had no legal duty to the particular persons who are plaintiffs, weren't in so-called "privity" with the plaintiffs, the plaintiffs did not "rely" on the defendant, etc. All of these words, or ideas, or whatever they are, are simply legalistic ways of saying that X should not be liable to Y because to make X liable to Y is just too much. Maybe X should be liable to A or B, but that is enough, and he should not be liable to Y. Often opening the door to liability to Y is claimed by courts to be opening the door to liability that is just too widespread.

In the Madoff case, feeder funds will put forth this non-liability position if sued by people who did not invest with it. Giant institutions that sniffed out the truth or suspected it, and therefore refused to do business with Madoff but said nothing to the SEC or FINRA, will put forth the same position if sued because they warned nobody. And, in the current state of the law, they likely will succeed by using this defense.

But one wonders whether they *should* succeed: Or whether, on the other hand, the Madoff case, the cults of crookedness and silence on Wall Street, and the current American culture of dishonesty all counsel that there should be a change in the law in situations where big shots, the rich, those in the know, are aware of the truth or of what might very well *be* the truth, yet warn nobody and leave all others to twist in the wind. Writers like Joe Nocera, citing the actions of wealthy, sophisticated investment managers who had the knowledge and sophistication to suspect something was wrong, and the ability to investigate, like to pretend that, since *these* guys suspected something was wrong, *all* of us should have suspected something was wrong even though most of us lack even a fiftieth or a hundredth of the knowledge and due diligence capability of his wealthy Wall Street buddies. The argument would make a lot more sense if people like his buddies were required to share their suspicions, and the reasons for them, so that the rest of us could stand forewarned instead of ignorant.

Anyway, with so much crookedness going on, one thinks that all the old (*very* tired) arguments about why huge institutions have no duty or liability to people they, for example, were not doing business with, should be scrapped in favor of creating a duty of such institutions to warn - *at minimum* a duty to privately warn government authorities - when they have serious reason to suspect wrongdoing, and should have liability to the injured whose harm could have been avoided had an institution issued the needed warning (and had the government then acted if the duty to warn is limited to a duty to warn the government so that it can investigate).

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