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More On The Madoff Mess

National Affairs

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At this point in time, there still has not been much talk about lawsuits against the government or FINRA. I think the relative silence on these subjects to date arises from people's shocked focus on more immediate questions: what can they recover quickly and how do they go about this; will the bankruptcy trustee try to "claw back" from the innocent - from people who were financially hurt or wiped out - money they took out of their Madoff accounts in order to live; can they quickly sell their homes to raise money to live on; can they successfully get back into the work force, often by seeking entry level jobs though they are in their late 50s or their 60s or 70s. But the time is fast approaching when people will begin to focus on trying to obtain recovery of lost monies by the long term means of lawsuits against the government, FINRA, negligent feeder funds and negligent banks.

What is more, if I had to make a guess, it would be that, despite the expectable efforts of the SEC to minimize its negligence (I've even heard that it may be trying to get investors to pin the blame for their woes not on it but on their feeder funds), over time more and more will come out about how horrible its conduct was. This will be akin to the slow hemorrhaging of information about the derelictions of the Department of Justice with regard to torture, illegal electronic spying, politically inspired firing of U.S. attorneys, etc. - information the DOJ always wanted to keep secret but that ultimately

would not down.

Two things should now be said with regard to potential suits against the SEC. First, suit probably should not be brought against the SEC itself, or at least not against the SEC alone, but against the United States (i.e., the federal government). Second, there likely is error in the (ignorant) conventional wisdom - that the federal government or one of its constituent parts cannot be sued because of "sovereign immunity" - mouthed by the celebrity lawyers and academics whom the mass media love to quote - and who *become* celebrity lawyers and academics in part because they are willing to shoot off their mouths to the media in order to be quoted even if they don't know what they are talking about.

One should not sue the SEC, or the SEC alone, because the amount of money needed to make people whole is not in the SEC's possession, but in the possession of the United States Government. And the SEC is *part* of the United States Government, which is liable for the SEC's derelictions (just like a corporation is liable for the unlawful action of one of its parts).

As well, there is some possibility that not just the SEC, but the IRS too - another part of the USG - may have negligently failed to blow the whistle on Madoff's scam. As I (incompletely) understand the latter possibility, it arises because the IRS, I'm told, carefully checks taxpayers' declarations of dividends and interest against corporations' submitted records of payments of interest and dividends, in order to insure that a taxpayer is not shortchanging it and is not withholding taxes to which it has a right. But, not caring if a taxpayer is *overpaying* it and giving it taxes to which it has *no right*, the IRS does not tell a taxpayer when a comparison of his/her reported interest and dividends against the amounts a corporation says it has paid shows that there were *no such* interest or dividends paid by the corporation. I'm told, in short, that the IRS plays a heads we win, tails you lose game with the taxpayer. Had it played it straight - had it told taxpayers that corporations were *not* reporting having paid dividends and interest on which the taxpayers were paying tax, the whistle would have been blown on Madoff years ago. (The IRS plays another, similarly unfair game because, if a taxpayer defrauds it out of taxes, it can go back 10, 20, 30, 40 years to collect the taxes it was owed, but, if fraud on the taxpayer causes him to pay the IRS taxes it is *not* owed, the taxpayer is allowed to recover only the last three years of taxes.)

So one should sue the USG as well as, or instead of, the SEC. Is a suit against the USG permissible even though the USG and the SEC will claim they cannot be sued because of so-called "sovereign immunity"? I think the answer very likely is yes.

Sovereign immunity is an obnoxious doctrine. It is a relic of the divine right of kings, and was created when the king literally owned the courts - he was not about to be sued in courts that he himself owned. It is the death of the rule of law, since it allows the government to illegally injure someone, even illegally kill someone, yet be immune from suit for damages.

Recognizing the obnoxious, the horrific, character of this doctrine, the courts and Congress have made various inroads on it. One is the Federal Torts Claims Act (FTCA), under which a citizen can sue the government for negligently injuring him, among other things.

When a citizen sues the government under the FTCA for injury it caused, the government can defend by saying that its act (or the act of its employee) was within its discretion even if it turned out to be a mistake, was in accordance with the social, economic or policy goals of the statute, or was mandated by a particular regulation. But if its act was *not* in accordance with the statutory policy, was *not* mandated by a particular regulation, was *not* one it had discretion to take or not take under the statutory policy, its defense falls to the ground.

Here it is very hard to understand how the government's defense could do anything other than fall to the ground. Can the government seriously claim that it had discretion to ignore the largest fraudulent Ponzi scheme in history under the social, political and economic policies of the federal securities laws - enacted in the early 1930s in order to stop frauds because they had contributed heavily to the depression and enacted to safeguard investors against fraud? Can it seriously claim that under these laws, it had discretion *not* to conduct a thorough, non-horribly-negligent investigation when presented with a memorandum of warning as thorough, as detailed, as Markopolos'? Can it even point to any internal policy or regulations, however out of joint with the underlying laws such internal policy might be, that allowed it *not* to thoroughly investigate an *extensively* documented - and *correct* - claim of the largest Ponzi scheme in history? Moreover, there are lawyers with extensive SEC experience who think that the legal process called "discovery," in which the SEC will have to turn over its internal manuals and policies, will show that it grossly violated its own internal policies by its slipshod - or even complicitous - conduct.

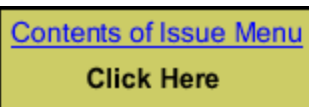
So, it seems to me, at least, that the SEC and the USG are going to be liable in damages here under the FTCA for the horrendously negligent, anti-the-policy-of-the-securities-acts conduct of the SEC.

Just a word about FINRA. FINRA's negligence was virtually as bad as the SEC's. It, and its predecessor, the NASD, could have discovered and put a stop to this fraud decades ago by simply demanding answers to questions, and relevant documents, pertaining to the brokerage operation (questions like "Where are the securities you are holding for the firm's clients? Show them to us.") It can assess the members of the brokerage industry - who have been paying it only \$150 per brokerage company per year for many, many years - to obtain the money to pay investors for all the money they lost due to its negligence. And it is only a matter of time until lawyers begin to realize that FINRA should be a defendant and begin to make it a defendant.

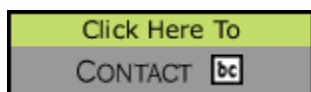
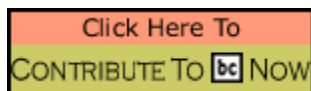
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