REPORT OF INVESTIGATION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
OFFICE OF INSPECTOR GENERAL

Case No. OIG-560

Investigation of Conflict of Interest Arising from Former General Counsel's Participation in Madoff-Related Matters

September 16, 2011

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INTRODUCTION AND BACKGROUND

On March 4, 2011, Chairman Mary L. Schapiro of the Securities and Exchange Commission ("SEC" or "Commission") requested that the SEC Office of Inspector General ("OIG") investigate any conflicts of interest arising from the participation of David M. Becker, the former General Counsel and Senior Policy Director of the Commission, in determining the SEC's position in the liquidation proceeding brought by the Securities Investor Protection Corporation ("SIPC") of Bernard L. Madoff Investment Securities, LLC ("BMIS"). On that same day, the OIG opened this investigation.

The Chairman's request came after she received inquiries from certain Congressional committees and subcommittees requesting information and documents related to, among other things, Becker's participation in the SEC's work in the SIPC liquidation proceeding ("Madoff Liquidation"). Both Becker and Chairman Schapiro provided written responses to these inquiries, and Chairman Schapiro testified regarding this issue before a subcommittee of the U.S. House of Representatives Committee on Oversight and Government Reform on March 10, 2011.

These Congressional inquiries came in response to press reports indicating that Becker had been named as a defendant in a clawback suit brought by the trustee administering the Madoff Liquidation. The first such article appeared on February 22, 2011, and additional press coverage followed. The clawback suit was one of many brought by the Trustee who administered the Madoff Liquidation to recover money from Madoff investors ("Trustee"), and the suit against Becker and his brothers, both individually and as executors of their mother's estate, sought recovery of the fictitious profits that accrued to them as beneficiaries of their mother's estate when her BMIS account was liquidated after her death.

The Madoff Liquidation began after the SEC charged BMIS and Bernard L. Madoff with securities fraud, after his confession to a multi-billion dollar Ponzi scheme on December 11, 2008. On that same day, federal authorities in the Southern District of New York arrested Madoff and brought criminal charges against him for securities fraud.

On March 12, 2009, Madoff pled guilty to all eleven charges brought against him, and on June 29, 2009, he was sentenced to serve a maximum sentence of 150 years in prison.

After Madoff's confession, the OIG commenced an investigation into the SEC's failure to detect Madoff's Ponzi scheme, and, on August 31, 2009, the OIG issued Report No. OIG-509, a 457-page report entitled "Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme." That OIG investigation found that the SEC received six substantive complaints between June 1992 and December 2008 that raised significant red flags concerning Madoff's investment adviser operations and should have led to questions about whether Madoff was actually engaged in trading. The OIG investigation also found that the SEC was aware of two articles regarding Madoff's investment operations that appeared in reputable publications in 2001 questioning Madoff's unusually consistent investment returns. The OIG concluded that, notwithstanding these six complaints and two articles, the SEC did not conduct a competent and thorough examination or investigation into Madoff that, if done properly, would have led the SEC to identify Madoff's fraud. The OIG did not find that senior officials at the SEC directly attempted to influence examinations or investigations of Madoff or BMIS, or that any senior SEC official interfered with the staff's ability to perform its work.

EXECUTIVE SUMMARY

The OIG conducted an extensive investigation of the facts and circumstances surrounding the SEC's former General Counsel and Senior Policy Director David Becker's participation in issues in the Madoff Liquidation and other Madoff-related matters, notwithstanding his interest in the Madoff account of his mother's estate. During the course of its investigation, the OIG obtained and searched over 5.1 million e-mails for a total of 45 current and former SEC employees for various time periods pertinent to the investigation, ranging from 1998 to 2011. The OIG also obtained and analyzed internal SEC documents, documentation provided by the Madoff Trustee, Irving H. Picard, Esq., court filings, and press reports. In addition, the OIG conducted testimony or interviews of 40 witnesses with knowledge of facts or circumstances surrounding the Madoff Liquidation and Becker's work at the SEC.

Overall, the OIG investigation found that Becker participated personally and substantially in particular matters in which he had a personal financial interest by virtue of his inheritance of the proceeds of his mother's estate's Madoff account and that the matters on which he advised could have directly impacted his financial position. We found that Becker played a significant and leading role in the determination of what recommendation the staff would make to the Commission regarding the position the SEC would advocate as to the determination of a customer's net equity in the Madoff Liquidation. Under the Securities Investor Protection Act of 1970 ("SIPA"), where SIPC has initiated the liquidation of a brokerage firm, net equity is the amount that a customer can claim to recover in the liquidation proceeding. The method for determining the Madoff customer's net equity was, therefore, critical to determining the amount the Trustee would pay to customers in the Madoff Liquidation. Testimony obtained from

SIPC officials and numerous SEC witnesses, as well as documentary evidence reviewed, demonstrated that there was a direct connection between the method used to determine customer net equity and clawback actions by the Trustee, including the overall amount of funds the Trustee would seek to clawback and the calculation of amounts sought in individual clawback suits. In addition to Becker's work on the net equity issue, we also found that Becker, in his role as SEC General Counsel and Senior Policy Director, provided comments on a proposed amendment to SIPA that would have severely curtailed the Trustee's power to bring clawback suits against individuals like him in the Madoff Liquidation.

After we concluded the fact-finding phase of our investigation, we provided to the Acting Director of the Office of Government Ethics ("OGE") a summary of the salient facts uncovered in the investigation, as reflected in this report. We requested that OGE review those facts and provide the OIG with its opinion regarding Becker's participation in matters as the SEC's General Counsel and Senior Policy Director that could have given rise to a conflict of interest. After reviewing the summary of facts provided by the OIG, the Acting Director of OGE advised us that in his opinion, as well as that of senior attorneys on his staff, both Mr. Becker's work on the policy determination of the calculation of net equity in connection with clawback actions stemming from the Madoff matter, and his work on the proposed legislation affecting clawbacks, should be referred to the United States Department of Justice for consideration of whether Becker violated 18 U.S.C. § 208, a criminal conflict of interest provision. Based upon this guidance, the OIG is referring the results of its investigation to the Public Integrity Section of the Criminal Division of the United States Department of Justice.

The following is a summary of the findings of our investigation. We found that Becker, along with his two brothers, inherited an interest in a Madoff account owned by his mother's estate after she died in 2004. Becker testified he became aware of his mother's estate's Madoff account in or about February 2009 and knew that the account had been opened by his father prior to his death in 2000, that it was transferred to his mother's estate after her death in 2004, and that the account was liquidated for approximately $2 million. According to the complaint filed by the Madoff Trustee against Becker and his brothers in February 2011, approximately $1.5 million of the $2 million in the Madoff account constituted fictitious profits and, therefore, should properly be clawed back into the fund of customer property for distribution to other Madoff customers.

The OIG investigation found that at the time Becker participated on behalf of the SEC in the net equity issue presented in the Madoff Liquidation, he understood there was a possibility the Trustee would bring a clawback suit against him for the fictitious profits, but asserted that he did not know the likelihood of such a suit. He also acknowledged at the time that it was at least "theoretically conceivable" that the determination of the extent of SIPA coverage to be afforded Madoff customers could impact whether the Trustee would bring clawback actions against "persons at the margin," which he considered himself to be. Notwithstanding this knowledge, Becker, who also served as

the SEC's alternate Designated Agency Ethics Official (*i.e.*, the alternate official responsible for coordinating and managing the SEC's ethics program), worked on particular matters that could impact the likelihood, and even possibility, of a clawback suit against him, as well as the amount that could be recovered in such a clawback action.

Specifically, the OIG investigation found that after Becker rejoined the SEC as General Counsel and Senior Policy Director in February 2009, the SEC's approach with respect to the net equity determination changed. Prior to Becker's return to the Commission, the Division of Trading & Markets (TM) had been working closely with SIPC on the Madoff Liquidation. At that time, SIPC had emphasized that it was critical that SIPC and the SEC reach a consensus and agree on a methodology for paying customer claims, as SIPC and the Trustee wished to act quickly and begin paying customer claims as soon as possible. SIPC and the Trustee proposed to pay customer claims based upon a money-in/money-out method of distribution, under which a Madoff investor would be able to make a net equity claim only for the amount initially invested with Madoff, less any amounts withdrawn over time ("Money In/Money Out Method"). SIPC and the Trustee believed that the Money In/Money Out method was the only method that was consistent with SIPA as a matter of law, and that SIPA did not allow customers to receive any amount over and above their initial investment with Madoff, *i.e.*, the fictitious returns shown on their Madoff account statements. As of February 2009, TM officials concurred with SIPC and the Trustee that the Money In/Money Out Method was the appropriate method for determining customer net equity and SIPC officials understood that the Commission was likewise in agreement with this approach.

After Becker rejoined the Commission in late February 2009, and the SEC received submissions from representatives of Madoff claimants who disagreed with the Money In/Money Out Method for determining net equity, including a May 1, 2009 letter to Becker from former SEC Commissioner Annette Nazareth, Becker and the Office of General Counsel ("OGC") began to analyze whether an approach other than the one recommended by SIPC and the Trustee should be used. The May 1, 2009 letter, as well as other similar submissions, advocated a last account statement method for determining customer net equity, under which customers would receive the amount listed as being in the customer's account on the last Madoff account statement the customer received (*i.e.*, including the fictitious profits reflected on their statements) ("Last Account Statement Method").

The OIG investigation found that after receiving the May 1, 2009 letter, Becker and OGC initially gave serious consideration to the Last Account Statement Method. The OIG investigation further found that the prevailing opinion within the SEC and SIPC was that using the Last Account Statement Method would have eliminated the Trustee's ability to bring clawback suits such as the one brought against Becker. Becker himself testified to the OIG that he recalled that one of the reasons given by the Madoff Trustee for his opposition to using the Last Account Statement Method was that if this method was adopted, "we couldn't do any clawbacks."

In addition, Becker initially advocated to SIPC that some version of the Last Account Statement Method be adopted. SIPC's General Counsel stated to the OIG that during a June 2009 meeting, Becker "was very persistent on the view that the last account statement should be the measure of what customers were owed, which meant that you would basically recognize and honor fictitious profits." Meanwhile, SIPC officials expressed frustration to the SEC Chairman that the Commission was still exploring other options for the net equity determination while the Trustee was processing claims and wished to offer settlements to Madoff customers.

Becker and OGC eventually rejected the Last Account Statement Method and variations of that approach, determining that they could not be reconciled with the law, but continued to consider other methods that would allow Madoff customers to receive from SIPC more than the amount of their initial investments with Madoff. After consultation with officials from Division of Risk, Strategy, and Financial Management (Risk Fin), Becker ultimately decided to recommend to the Commission a method that became known as the Constant Dollar Approach, pursuant to which an inflation rate, based upon the Consumer Price Index, would be added to the amount of Madoff customers' initial investments with Madoff to determine the amount they would receive ("Constant Dollar Approach").

Accordingly, in late October 2009, eight months after Becker rejoined the Commission, Becker signed an Advice Memorandum to the Commission which proposed that the Commission support the Madoff Trustee's Money In/Money Out Method, but calculate this approach in a manner that accounts for the "time value" of funds invested in Madoff's scheme pursuant to the Constant Dollar Approach. TM concurred in the recommendation to support the Money In/Money Out Method, but specifically stated that it "does not necessarily concur with the view that SIPA would permit the calculation of net equity on a time-equivalent-dollar basis." Subsequently, Becker and OGC provided a Supplemental Memorandum to the Commission that specifically addressed the Constant Dollar Approach in greater detail. At an Executive Session of the Commission convened to consider this matter, Becker requested that the Commission authorize the staff to "prepare testimony and write a brief taking the position supporting the trustee on [money-in/money-out], but saying the [money] needs to described in constant dollar terms." The Commission ultimately voted not to object to the staff's recommendation of the Constant Dollar Approach to the net equity determination.

The OIG investigation found that neither SIPC nor the Trustee believed that the Constant Dollar Approach was appropriate or in conformance with the statute. The President and Chief Executive Officer ("CEO") of SIPC stated to the OIG that he specifically recalled telling Becker, in a telephone conversation during which Becker informed him that the Commission would use the Constant Dollar Approach, that there was no justification for such an approach under SIPA. Becker testified that he did not care about whether SIPC was unhappy with the SEC's approach to the appropriate method of calculating net equity because "[w]e're supposed to do the right thing . . . whether SIPC likes it or not." He was also dismissive in his testimony of the potential

impact on the SIPC Fund, which he referred to as "a little bit of a red herring," notwithstanding SIPC's previously-expressed concerns about the viability of the fund. Similarly, the OIG investigation found that despite knowing that SIPC and the Madoff Trustee wanted to act quickly and had begun processing customer claims, Becker and OGC delayed its net equity recommendation until it had to do so pursuant to the court's scheduling order.

Moreover, the SIPC President and CEO made clear that every proffered methodology, other than the Money In/Money Out Method that was agreed upon by the SEC prior to Becker's rejoining the Commission, would have directly affected Becker's mother's estate's account, and every proffered methodology would have improved Becker's financial position, or the financial position of the account. The SIPC President and CEO explained that by increasing the amount that customers' accounts were owed, Becker would decrease any amount which the trustee could have received in a clawback suit.

The SIPC President and CEO also stated that, upon learning of Becker's mother's Madoff account, he performed "back of the envelope calculations" to determine the difference of bringing clawback suits under the Constant Dollar Approach, as opposed to the money-in/money-out method. Under this calculation, the SIPC President and CEO concluded that utilizing the Constant Dollar Approach, the amount sought in the clawback suit against Becker and his brothers would be reduced by approximately $140,000. The OIG recreated the analysis and calculated that a benefit to Becker and his brothers of approximately $138,500 would result from applying the Constant Dollar Approach in the Becker clawback suit by adjusting the amount of principal invested of approximately $500,000 by a percentage inflation adjustment calculated from the Department of Labor's Bureau of Labor Statistics Consumer Price Index Table.

The OIG investigation also found that Becker participated in another particular matter while serving as General Counsel and Senior Policy Director that could have impacted his financial position. In October 2009, the SEC's Office of Intergovernmental and Legislative Affairs (OLA) forwarded Becker a draft amendment to SIPC, as well as TM's analysis of that proposal, and asked Becker if there was "any reason SEC staff should weigh in tomorrow on an amendment to be considered during a House Financial Services Committee markup regarding the ability of the SIPC trustee to do clawbacks." The proposed amendment was entitled, "Clarification Regarding Liquidation Proceedings," and amended SIPA to preclude a SIPC trustee from bringing clawback actions against a customer "absent proof that the customer did not have a legitimate expectation that the assets in his account belonged to him." The effect of this amendment would be to preclude the Trustee from bringing clawback actions like the one against Becker, which were the majority of the clawback suits brought, *i.e.*, suits that did not rely on any knowledge of the alleged wrongdoing. Becker responded to OLA, stating the amendment was "incomprehensible" and did not "seem fair" to him. In his OIG testimony, Becker defended his participation in this matter by stating that he regarded this amendment as merely "political noise," rather than a serious proposal.

Although the OIG investigation did find that Becker consulted with the SEC Ethics Office regarding his interest in his mother's estate's Madoff account on two separate occasions and Becker was advised that there was no conflict, we identified concerns about the role and culture of the Ethics Office at the time it provided Becker with clearance to work on the Madoff Liquidation. William Lenox, the Ethics Counsel, with whom Becker consulted on both occasions about whether he should be recused from working on the Madoff Liquidation, reported directly to Becker. In fact, just seven months after Lenox provided advice regarding Becker's participation in the Madoff Liquidation, Becker provided a performance evaluation of Lenox, which concluded, "The performance of the ethics office has been superb . . . . The quality of the ethics advice is very high . . . ." Lenox also held Becker in extremely high regard. He testified that he had "[g]reat professional respect" for Becker and "an appreciation for his humor and his abilities as a lawyer," and further described Becker as a "great man and a great lawyer." He also testified he factored into his analysis of whether Becker should be recused from the Madoff Liquidation the fact that "he was a reputed securities lawyer who was making a decision to come back and serve the public and protect investors, and he was here to do this sort of analysis."

In addition, Lenox explained his belief that as Ethics Counsel, the most important thing was that people trust him, and noted that people trusted him with "incredibly personal information." He viewed his job as "to create a culture where people would seek advice, and to alert those employees – all employees – where the danger lines were, and to encourage them to come and seek ethics advice, because that provides a level of protection." He stated, "The people who, in the ethics community, that I respect the least are the ones who always say no. If you are a constant naysayer, one, nobody comes to secure advice; two, you're not actually doing your job." He further noted, "The key, as I saw it in my job as [Designated Agency Ethics Official] and as ethics counsel, was to make decisions. That's the reason I was promoted. I was willing to make decisions. That requires a certain amount of willingness to be second-guessed by other people. If you always say no, you'll never be second-guessed. That was not what I saw my role to be."

Lenox specifically discussed Becker's mother's estate's Madoff account with him on two separate occasions: first, upon Becker's return to the SEC in February 2009, and, second, when he received the May 1, 2009 letter advocating the Last Account Statement Method. Only the second discussion was documented in writing, but at no time did Lenox advise that Becker should not participate in any Madoff-related matters and, as discussed below, this advice appears to have been based on incorrect assumptions. The OIG investigation further found that Becker never advised Lenox of the request for his opinion of the SIPA amendment, which would have precluded clawbacks against individuals in Becker's position, and never sought his advice on whether providing advice on the amendment was improper.

In the second discussion in early May 2009, Becker disclosed to Lenox the details of his mother's account with Madoff, including when it was opened and closed, and approximately how much money was invested. He also explained to Lenox that the Madoff Trustee had been bringing clawback suits and that a clawback suit could "[i]n theory" be brought against him. Becker also acknowledged that it was possible that the extent to which SIPA coverage would be available could make it "less likely that the [t]rustee would bring claw back actions against persons at the margin" like him.

Lenox responded, in part, "There is no direct and predictable effect between the resolution of the meaning of 'securities positions' and the trustee's claw back decision. For this reason, you do not have a financial conflict of interest and you may participate." When the OIG interviewed Lenox in this investigation, we learned that Lenox's opinion was based upon the incorrect understanding that the SEC's participation in the Madoff Liquidation was solely an advisory one, when, in fact, the SEC is a party to the liquidation proceeding and may request the court to compel SIPC to do as it wishes. Becker himself acknowledged in his OIG testimony that consistent with its role as a party, the SEC's participation in the net equity issue in the Madoff Liquidation was not theoretical. Becker noted that it was his understanding that if SIPC disagreed, the SEC should eventually recommend that the court adopt the SEC's position, not SIPC's position, and indicated that "[t]he Commission had done that in the past and may do it again."

We found that Lenox's advice was also based upon the incorrect assumption that the interpretation of SIPA for purposes of claim determination was a separate and distinct legal question from the trustee's decision of from whom to institute a claw back suit, and completely ignored any impact on the calculation of the amount to be clawed back. We also found no evidence that Lenox took any further steps to better understand the extent and nature of Becker's involvement in the Madoff Liquidation and Becker testified that he did not recall Lenox asking for additional facts or directing him to seek additional guidance if new facts arose.

The OIG investigation further found that notwithstanding the importance Lenox had placed on appearance matters in his communications to SEC employees, he did not even reference appearance considerations in his May 2009 written advice to Becker. Nonetheless, Lenox testified that he did consider appearance issues when advising Becker and, in fact, concluded that Becker's participation in the Madoff Liquidation matter passed the "appearance of impropriety test," which Lenox had himself described in an ethics bulletin issued to all SEC employees as follows:

> What are the optics of the situation; what is the context of the facts and circumstances? Would it pass what has often been referred to as the *New York Times* or *Washington Post* test? If what you propose doing becomes the subject of an article in the press, would you not care or would it look like you were doing something wrong? Even if you wouldn't

> care, what effect would the story have on the SEC and your fellow employees?

Even with the advantage of hindsight and given the intense press scrutiny and criticism of Becker's work on Madoff-related matters in the Washington Post and New York Times, Lenox indicated in testimony before the OIG that he stands by his conclusion that Becker's involvement in the SEC determinations in the Madoff Liquidation passed this appearance test.

The OIG investigation further found that the Ethics Office considered Becker's participation differently in other matters than it did in the Madoff Liquidation. For example, in March 2009, shortly after he returned to the Commission, Lenox advised Becker to recuse himself from the Commission's consideration of an insider trading matter involving a company in which Becker held about $90,000 in securities of issuers that were harmed by the trading at issue in the case. In this case, the basis for recusal was a "theoretical possibility" of some benefit to Becker, which seems significantly less likely than the situation presented by Becker's participation in the Madoff SIPC liquidation proceeding.

Becker himself also took a more conservative stance on recusal in certain matters, and even declined to participate in one matter where the Ethics Office had advised he could do so. For example, in July 2010, Becker discussed recusal from an SEC enforcement matter with the Ethics Office. The Ethics Office informed Becker that he previously already recused himself from this matter because of certain holdings. Becker responded, "I recused because of a brief (under 30 minutes) involvement with the case. Ultra conservative, but wise."

Similarly, the OIG investigation found that the Ethics Office considered recusals in Madoff-related matters differently in situations that did not involve Becker. Shortly after Madoff confessed, Lenox, as Ethics Counsel, sent a memorandum to all Commission employees regarding mandatory recusal from *SEC v. Madoff* in a broad variety of circumstances. The memorandum stated, "[A]ny member of the SEC staff who has had more than insubstantial personal contacts with Bernard L. Madoff or Mr. Madoff's family shall be recused from any ongoing investigation of matters related to *SEC v. Madoff*." The memorandum further set forth certain contacts that required recusal, including being invited to or visiting any Madoff family members' homes or being an active member of the same social or charitable organizations.

In addition, the OIG investigation found that with respect to employees within OGC besides Becker, the Ethics Office took a more conservative approach for recusal from Madoff-related matters, including the Madoff Liquidation. For example, the Ethics Office advised a staff attorney in OGC's Appellate Litigation and Bankruptcy Group, that she had a conflict from working on any aspect of the Madoff Liquidation because she "spent a very small amount of time in private practice working on a question related to the Madoff bankruptcy."

Becker himself took a different approach when he analyzed SIPA coverage issue for investors in the multi-billion Ponzi scheme of R. Allen Stanford from the approach described above in the Madoff Liquidation. After the SEC brought a civil enforcement action against Stanford and three of his companies, the President and CEO of SIPC sent a letter to the receiver appointed for the Stanford matter indicating that, based on the facts as set forth by the receiver, there was no basis for SIPC to initiate a proceeding under SIPA with respect to Stanford investors. Becker testified that he became involved initially in the SEC's considerations about SIPC coverage with respect to Stanford investors, and his opinion as to the matter "was that SIPA, the statute, did not cover the Stanford situation," noting that although "it didn't make sense that it would not cover something like Stanford, but cover Madoff, . . . the law is the law." By contrast, in the Madoff Liquidation, Becker considered a variety of approaches for determining net equity in order to, as Becker testified, "take the position which got the most money [to] injured investors consistent with the law." After Becker left the SEC, the Commission eventually adopted a position contrary to the one espoused by Becker, finding that the law did allow certain Stanford investors SIPA protection.

The OIG investigation also found that former Ethics Counsel Lenox was not the only individual in the Commission who was aware of Becker's mother's estate having an account with Madoff prior to the time this issue appeared in the press. Both Becker and Chairman Schapiro recalled that, around the time of his return to the SEC in February 2009, Becker discussed his mother's estate's Madoff account with her. While their recollections of the substance of the conversation are not entirely consistent, the evidence clearly shows that Becker advised Chairman Schapiro that his mother had had an account with Madoff, that she had died several years before, and that the account had been liquidated. Chairman Schapiro did not recall asking Becker any questions after he told her about his mother's account, and did not recall whether Becker said anything about seeking advice from the Ethics Counsel regarding the account, although Becker testified he must have mentioned to her that he would consult with Lenox. At that time, Chairman Schapiro did not consider Becker's personal financial gain "in any way, shape, or form" or whether he would be subject to a clawback action. Indeed, Chairman Schapiro testified that she would have had Becker recused from the net equity determination if she had known he was potentially subject to a clawback suit or "understood that he had any financial interest in how this [was] resolved . . . ."

In addition, the issue of Becker's mother's estate's Madoff account was discussed by several SEC senior officials in the Fall of 2009, when the SEC learned that the U.S. House of Representatives Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises was scheduling a hearing on SIPC and the Madoff victims. Shortly after the SEC learned that the Congressional testimony would focus on legal aspects of the SIPC/Madoff issues, Chairman Schapiro suggested that Becker testify on behalf of the SEC at the hearing. The OLA Director then had a conversation with Becker, during which Becker informed him that his mother had a Madoff account from which he "had gotten an inheritance." Becker also testified that he told the OLA Director

that "if [he did] testify, [he] would put at the beginning, [he] would mention [his], the fact of [his] mother's account with Madoff." Becker testified that after this conversation, the OLA Director contacted him later in the day and said, "You know, now that I think about it, I think it would be better if somebody else testified. My concern is – not that there's anything inappropriate, but my concern is [ ] that when you're in a political environment, people might want to make something of that, and it would be a distraction rather than focusing on what the Commission's position was and why."

Becker testified that either the evening of his conversation with the OLA Director or the following morning, he spoke with Chairman Schapiro about his mother's account. Chairman Schapiro recalled the conversation with Becker and stated, "I recall saying that if David [Becker] did testify, we needed to make it absolutely clear to Congress that there was this connection, remote though I believed it to be, that his long-deceased mother had had an account at Madoff, so that nobody would be surprised by that, so that we were completely forthcoming with Congress." Becker testified that he was certain that it was he who said in the meeting with Chairman Schapiro that if he were to testify, he would disclose his mother's account with Madoff. The OIG investigation found that eventually, the OLA Director made the decision not to have Becker testify and the SEC Deputy Solicitor, who had been suggested by Becker as a possible replacement witness, testified in Becker's stead at the subcommittee hearing which occurred on December 9, 2009, and involved discussions of clawbacks. In the end, Becker's Madoff interest was not disclosed to Congress.

Moreover, the OIG investigation found that although the decision was made that should Becker testify before Congress, he would disclose his mother's interest with Madoff, during this November 2009 timeframe, the fact of Becker's interest in his mother's estate's Madoff account was not disclosed to the Commissioners or the bankruptcy court, notwithstanding the fact that the Commission was considering Becker's recommendation on the net equity position to take in court at this very time. SEC Commissioner Aguilar testified that it was "incredibly surprising and incredibly disappointing that there was enough awareness to know that the conflict existed to prevent [Becker] from giving [this] testimony, yet the decision-makers at the Commission were not provided that information."

In all, the OIG investigation found that, prior to the public disclosure of Becker's mother's Madoff account, at least seven SEC officials were informed at one time or another about that account, including the Chairman, the then-Deputy General Counsel and current General Counsel, the Deputy Solicitor who testified at the hearing in Becker's stead, the OLA Director, a Special Counsel to the Chairman and the two Ethics officials, and yet, none of these individuals recognized a conflict or took any action to suggest that Becker consider recusing himself from the Madoff Liquidation.

The rest of the relevant personnel who worked with Becker on the Madoff Liquidation found out about Becker's mother's account from the media. These included: all the TM personnel who played a role in the Madoff Liquidation, OGC lawyers who

worked with Becker on the net equity determination, all of the SEC Commissioners, other than the Chairman, SIPC's President and CEO as well as its General Counsel, and the Madoff Trustee. Virtually all these individuals expressed some level of surprise at the revelation, and many expressed concern about the potential conflict of interest.

On August 31, 2011, after completing the fact-finding aspect of this investigation, the OIG provided to the Acting Director of OGE a summary of the salient facts uncovered in the investigation, as reflected in this report. The OIG requested that OGE review those facts and provide the OIG with its opinion regarding Becker's participation in matters as the SEC's General Counsel and Senior Policy Director that could have given rise to a conflict of interest.

After reviewing the summary of facts provided by the OIG, the Acting Director of OGE provided the following guidance to the OIG: "It is [the OGE's Acting Director's] opinion, as well as that of senior attorneys on [his] staff, that certain matters [the OIG] discussed in the materials [the OIG] provided to OGE should be referred to the United States Department of Justice for its consideration. This regards, more specifically: (a) Mr. Becker's work as General Counsel on the policy determination of the calculation of net equity in connection with clawback actions stemming from the Madoff matter, and (b) Mr. Becker's SEC work on the proposed legislation affecting clawbacks." He also stated that the OGE attorneys' view was that "the materials provided to OGE contain information relevant to two elements of 18 USC 208, to the extent they evidence Mr. Becker's apparent personal and substantial participation in both of the particular matters above, and to the extent there is implicated a personal financial interest that could be impacted by Mr. Becker's participation in those matters. Nonetheless, the actual knowledge element of 18 USC 208, which would be required to establish a violation of that statute, remains a question of fact that can only be resolved in a court of law."

Based upon this guidance, the OIG is referring the results of its investigation to the Public Integrity Section of the Criminal Division of the United States Department of Justice. In addition, based upon the OIG's findings in this report, the OIG is recommending that, in light of David Becker's role in signing the October 28, 2009 Advice Memorandum and participating in the November 2009 Executive Session at which the Commission considered OGC's recommendation that the Commission take the position that net equity for purposes of paying Madoff customer claims should be calculated in constant dollars by adjusting for the effects of inflation, the Commission reconsider its position on this issue by conducting a re-vote in a process free from any possible bias or taint. Once the re-vote has been conducted, the Commission should advise the United States Bankruptcy Court for the Southern District of New York of its results and the position that the Commission is adopting.

The OIG also recommends with respect to the Ethics Office that:

(1) The SEC Ethics Counsel should report directly to the Chairman, rather than to the General Counsel.

(2) The SEC Ethics Office should take all necessary steps, including the implementation of appropriate policies and procedures, to ensure that all advice provided by the Ethics Office is well-reasoned, complete, objective, and consistent, and that Ethics officials ensure that they have all the necessary information in order to properly determine if an employee's proposed actions may violate rules or statutes or create an appearance of impropriety.

(3) The SEC Ethics Office should take all necessary actions to ensure that all ethics advice provided in significant matters, such as those involving financial conflict of interest, are documented in an appropriate and consistent manner.

SCOPE OF THE OIG INVESTIGATION

I. Review of E-mails

Between March 4, 2011 and August 16, 2011, the OIG made numerous requests to the SEC's Office of Information Technology ("OIT") for the e-mails of current and former SEC employees for various periods of time pertinent to the investigation. The e-mails were received, loaded onto computers with specialized search tools, and searched on a continuous basis throughout the course of the investigation.

In all, the OIG received from OIT e-mails for a total of 45 current and former SEC employees for various time periods pertinent to the investigation, ranging from 1998 to 2011. These included: 19 current or former employees within OGC; four current or former employees within the Division of Trading and Markets ("TM"); three current employees within the Office of Intergovernmental and Legislative Affairs ("OLA"); three current or former employees within the Division of Risk, Strategy, and Financial Management ("Risk Fin"); all four Commissioners and the Chairman, as well as five members of their staffs; and three current or former employees within the Division of Enforcement. In addition, the OIG loaded and searched e-mails that it had collected from five additional employees during its previous investigation into the failure of the SEC to uncover Madoff's Ponzi Scheme, Case No. OIG-509. The OIG estimates that it obtained and searched over 5.1 million e-mails during the course of its investigation.

II. Document Requests and Review of Records

The OIG obtained documents from the Secretary of the Commission, including minutes of certain Commission meetings and memoranda presented to the Commission regarding the Madoff Liquidation and SEC enforcement actions brought against individuals and entities related to BMIS. The OIG also reviewed a transcript of an Executive Session of the Commission that occurred on November 9 and 10, 2009 and

listened to recordings of two other Commission Executive Sessions that occurred on January 15 and February 12, 2009.

On May 31, 2011, the OIG issued a subpoena to Irving H. Picard, Esq., as Trustee for the liquidation of the BMIS business ("Trustee"). The Trustee produced documents pursuant to that subpoena on June 8, 2011, including documents related to the BMIS account held by Becker's mother's estate and to communications between the Trustee and Becker in his capacity as the Commission's General Counsel and Senior Policy Director.

The OIG also reviewed numerous publicly available documents, including: (1) court filings in the Madoff Liquidation; (2) court filings in various clawback actions brought by the Trustee, including the action against Becker and his brothers; and (3) press coverage of Madoff-related matters.

III. Testimony and Interviews

The OIG took the sworn testimony of 35 witnesses and interviewed five other individuals with knowledge of facts or circumstances surrounding the Madoff Liquidation and Becker's work at the SEC. SEC Inspector General H. David Kotz personally led the questioning in the testimony and interviews of nearly all the witnesses in the investigation.

The OIG conducted testimony on-the-record and under oath of the following 35 individuals:

1) *Risk Fin Senior Official #1, Division of Risk, Strategy, and Financial Innovation; taken on June 14, 2011 ("Risk Fin Senior Official # 1 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 1.

2) Michael Macchiaroli, Associate Director, Division of Trading and Markets; taken on June 14, 2011 ("Macchiaroli Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 2.

3) *Sr. TM Official, Division of Trading and Markets; taken on June 17, 2011 ("Sr. TM Official Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 3.

4) *NYRO Assistant Regional Director, Division of Enforcement, New York Regional Office; taken on June 22, 2011 ("NYRO Assistant Regional Director Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 4.

* The OIG redacted the identities of certain individuals because of privacy concerns.

5) Jacob Stillman, Solicitor, Office of the General Counsel; taken on June 23, 2011 ("Stillman Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 5.

6) *OGC Sr. Counsel #1, Office of the General Counsel; taken on June 29, 2011 ("OGC Sr. Counsel #1 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 6.

7) *Assistant Ethics Counsel #3, Office of the General Counsel; taken on June 29, 2011 ("Assistant Ethics Counsel #3 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 7.

8) Eric Spitler, Counselor to the Chairman and Director, Office of Legislative and Intergovernmental Affairs; taken on July 7, 2011 ("Spitler Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 8.

9) *OLA Deputy Director #2, Office of Legislative and Intergovernmental Affairs; taken on July 7, 2011 ("OLA Deputy Director #2 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 9.

10) *OGC Sr. Special Counsel, Office of the General Counsel; taken on July 7, 2011 ("OGC Sr. Special Counsel Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 10.

11) *OGC Assistant General Counsel #2, Office of the General Counsel; taken on July 12, 2011 ("OGC Assistant General Counsel #2 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 11.

12) Mark Cahn, General Counsel; taken on July 14, 2011 ("Cahn Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 12.

13) *OGC Assistant General Counsel #1, Office of the General Counsel; taken on July 14, 2011 ("OGC Assistant General Counsel #1 Testimony Tr."). Excerpts of testimony transcript re attached as Exhibit 13.

14) Luis Aguilar, Commissioner; taken on July 20, 2011 ("Aguilar Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 14.

15) Troy Paredes, Commissioner; taken on July 20, 2011 ("Paredes Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 15.

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* The OIG redacted the identities of certain individuals because of privacy concerns.

16) Kathleen Casey, former Commissioner; taken on July 21, 2011 ("Casey Testimony Tr."). Commissioner Casey remained a Commissioner at the time of her testimony, but she then left the Commission on August 5, 2011 after the completion of her five-year term. Excerpts of testimony transcript are attached as Exhibit 16.

17) Elisse Walter, Commissioner; taken on July 21, 2011 ("Walter Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 17.

18) *OLA Deputy Director #1, Office of Legislative and Intergovernmental Affairs; taken on July 21, 2011 ("OLA Deputy Director #1 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 18.

19) Ricardo Delfin, Special Counsel, Office of the Chairman; taken on July 21, 2011 ("Delfin Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 19.

20) Henry Hu, former Director of the Division of Risk, Strategy, and Financial Innovation; taken on July 22, 2011 ("Hu Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 20.

21) Michael Conley, Deputy Solicitor, Office of the General Counsel; taken on July 25, 2011 ("Conley Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 21.

22) Matthew Martens, Chief Litigation Counsel, Division of Enforcement; taken on July 25, 2011 ("Martens Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 22.

23) Joseph Brenner, Chief Counsel, Division of Enforcement; taken on July 26, 2011 ("Brenner Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 23.

24) *Assistant Ethics Counsel #1, Office of the General Counsel; taken on July 26, 2011 ("Assistant Ethics Counsel #1 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 24.

25) *Assistant Ethics Counsel #2, Office of the General Counsel; taken on July 26, 2011 ("Assistant Ethics Counsel #2 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 25.

* The OIG redacted the identities of certain individuals because of privacy concerns.

26) Mary L. Schapiro, Chairman; taken on July 27, 2011 ("Schapiro Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 26.

27) Harry Markopolos, Chartered Financial Analyst and Certified Fraud Examiner; taken on July 27, 2011 ("Markopolos Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 27.

28) *OGC Sr. Counsel #2, Office of the General Counsel; taken on August 10, 2011 ("OGC Sr. Counsel #2 Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 28.

29) *OHR Assistant Director, Office of Human Resources; taken on August 11, 2011 ("OHR Assistant Director Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 29.

30) *NYRO Staff Attorney, Division of Enforcement, New York Regional Office; taken on August 15, 2011 ("NYRO Staff Attorney Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 30.

31) *NYRO Trial Counsel, Division of Enforcement, New York Regional Office, taken on August 15, 2011 ("NYRO Trial Counsel Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 31.

32) Richard Levine, Associate General Counsel for Legal Policy, Office of General Counsel; taken on August 16, 2011 ("Levine Interview Tr."). Excerpts of testimony transcript are attached as Exhibit 32.

33) Jeffrey Risinger, former Director, Office of Human Resources; taken on August 18, 2011 ("Risinger Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 33.

34) William Lenox, former Ethics Counsel, Office of the General Counsel; taken on August 26, 2011 ("Lenox Testimony Tr."). Excerpts of testimony transcript are attached as Exhibit 34.

35) David Becker, former General Counsel; taken on August 29, 2011 ("Becker Testimony Tr."). Excerpts of Testimony Transcript are attached as Exhibit 35.

The OIG also conducted interviews of the following five persons with relevant expertise and/or knowledge of information pertinent to the investigation:

* The OIG redacted the identities of certain individuals because of privacy concerns.

1) Daniel Gallagher, former Deputy Director (July 2008 until April 2009) and Acting Co-Director (from April 2009 until January 2010), Division of Trading and Markets, currently Partner, Wilmer, Cutler, Pickering, Hale & Dorr, and awaiting confirmation as SEC Commissioner; conducted on July 22, 2011 ("Gallagher Interview Tr."). Excerpts of interview transcript are attached as Exhibit 36.

2) Stephen Harbeck, President and Chief Executive Officer, Securities Investor Protection Corporation; conducted on July 11, 2011 and on August 17, 2011 ("Harbeck Interview Tr."). Excerpts of the July 11, 2011 interview transcript are attached as Exhibit 37, and a memorandum of the August 17, 2011 interview is attached as Exhibit 38.

3) Annette Nazareth, former SEC Commissioner (from August 2005 until January 2008) and Director of the Division of Trading and Markets (from March 1999 until August 2005), currently Partner, Davis Polk & Wardwell; conducted on July 20, 2011 ("Nazareth Interview Mem."). A memorandum of the interview is attached as Exhibit 39.

4) Irving Picard, Trustee for the Liquidation of Bernard L. Madoff Investment Securities, LLC; conducted on August 3, 2011 ("Picard Interview Tr."). Excerpts of the interview transcript are attached as Exhibit 40.

5) Josephine Wang, General Counsel, Securities Investor Protection Corporation; conducted on July 11, 2011 ("Wang Interview Tr."). Excerpts of the interview transcript are attached as Exhibit 41.

RELEVANT STATUTES, RULES, AND REGULATIONS

Criminal Conflict of Interest Statute

The criminal conflict of interest statute for acts that affect a personal financial interest applies to all employees of the executive branch of the United States government and provides that whenever an executive branch employee:

> participates personally and substantially as a Government officer or employee, through decision, approval, disapproval, recommendation, the rendering of advice, investigation, or otherwise, in a judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, charge, accusation, arrest, or other particular matter in which, to his knowledge, he, his spouse, minor child, general partner,

> organization in which he is serving as officer, director, trustee, general partner or employee, or any person or organization with whom he is negotiating or has any arrangement concerning prospective employment, has a financial interest [s]hall be subject to the penalties set forth in section 216 of this title.

18 U.S.C. § 208(a). Section 216 provides the punishment for a violation of Section 208:

> Whoever engages in the conduct constituting the offense shall be imprisoned for not more than one year or fined in the amount set forth in this title, or both.
>
> Whoever willfully engages in the conduct constituting the offense shall be imprisoned for not more than five years or fined in the amount set forth in this title, or both.

Id. § 216(a)(1) and (2). It also provides that the Attorney General may bring a civil action for violation of Section 208. *Id.* § 216(b).

Standards of Ethical Conduct for Employees of the Executive Branch

The Standards of Ethical Conduct for Employees of the Executive Branch ("Standards of Conduct") are issued by the Office of Government Ethics ("OGE"). OGE was established by the Ethics in Government Act of 1978. 5 U.S.C. app. § 401. Its role is to provide "overall direction of executive branch policies related to preventing conflicts of interest on the part of officers and employees of any executive agency." *Id.* § 402(a). The Standards of Conduct set forth certain basic obligations of public service, including:

> Public service is a public trust, requiring employees to place loyalty to the Constitution, the laws and ethical principles above private gain.
>
> Employees shall endeavor to avoid any actions creating the appearance that they are violating the law of the ethical standards set forth in this part. Whether particular circumstances create an appearance that the law or these standards have been violated shall be determined from the perspective of a reasonable person with knowledge of the relevant facts.

5 C.F.R. § 2635.101(b)(1) and (14).

5 C.F.R. § 2635.402(a) describes what constitutes a disqualifying financial interest:

> An employee is prohibited by criminal statute, 18 U.S.C. § 208(a), from participating personally and substantially in an official capacity in any particular matter in which, to his knowledge, he or any person whose interests are imputed to him under this statute has a financial interest, if the particular matter will have a direct and predictable effect on that interest.

5 C.F.R. § 2635.402(b)(1) defines what constitutes a direct and predictable effect:

> A particular matter will have a direct effect on a financial interest if there is a close causal link between any decision or action to be taken in the matter and any expected effect of the matter on the financial interest. An effect may be direct even though it does not occur immediately. A particular matter will not have a direct effect on a financial interest, however, if the chain of causation is attenuated or is contingent upon the occurrence of events that are speculative or that are independent of, and unrelated to, the matter. A particular matter that has an effect on a financial interest only as a consequence of its effects on the general economy does not have a direct effect within the meaning of this subpart.
>
> A particular matter will have a predictable effect if there is a real, as opposed to a speculative possibility that the matter will affect the financial interest. It is not necessary, however, that the magnitude of the gain or loss be known, and the dollar amount of the gain or loss is immaterial.

5 C.F.R. § 2635.402(b)(4) defines what constitutes personal and substantial:

> To participate personally means to participate directly. It includes the direct and active supervision of the participation of a subordinate in the matter. To participate substantially means that the employee's involvement is of significance to the matter. Participation may be substantial even though it is not determinative of the outcome of a particular matter. However, it requires more than official responsibility, knowledge, perfunctory involvement, or involvement on an administrative or peripheral issue. A finding of substantiality should be based not only on the effort devoted to a matter, but also on the importance of the effort. While a series of peripheral involvements may be

> insubstantial, the single act of approving or participating in a critical step may be substantial. Personal and substantial participation may occur when, for example, an employee participates through decision, approval, disapproval, recommendation, investigation or the rendering of advice in a particular matter.

5 C.F.R. § 2635.402(b)(3) defines what constitutes a particular matter:

> The term particular matter encompasses only matters that involve deliberation, decision, or action that is focused upon the interests of specific persons, or a discrete and identifiable class of persons. Such a matter is covered by this subpart even if it does not involve formal parties and may include governmental action such as legislation or policy-making that is narrowly focused on the interests of such a discrete and identifiable class of persons. The term particular matter, however, does not extend to the consideration or adoption of broad policy options that are directed to the interests of a large and diverse group of persons. The particular matters covered by this subpart include a judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, charge, accusation or arrest.[1]

5 C.F.R. § 2635.502(a) requires employees to consider appearances of impropriety:

> Where an employee knows that a particular matter involving specific parties is likely to have a direct and predictable effect on the financial interest of a member of his household . . . and where the employee determines that the circumstances would cause a reasonable person with knowledge of the relevant facts to question his impartiality in the matter, the employee should not participate in the matter unless he has informed the agency designee of the appearance problem and received authorization from the agency designee in accordance with paragraph (d) of this section.

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[1] *See also Memorandum to Designated Agency Ethics Officials Regarding "Particular Matter Involving Specific Parties," "Particular Matter," and "Matter,"* OGE Informal Adv. Op. 06 x 9, 2006 WL 5380985 (Oct. 4, 2006).

The Commission's Canons of Ethics and Conduct Regulation

Employees of the Securities and Exchange Commission are required to bear in mind the Canons of Ethics for Members of the Securities and Exchange Commission, 17 C.F.R. § 200.50 *et seq.*, in the performance of their duties. 17 C.F.R. § 200.51. The Canons state in part:

> The question [of qualification to participate] in a particular matter rests with that individual member. Each member should weigh carefully the question of his qualification with respect to any matter wherein he or any relatives or former business associates or clients are involved. He should disqualify himself in the event he obtained knowledge prior to becoming a member of the facts at issue before him in a quasi-judicial proceeding, or in other types of proceeding in any matter involving parties in whom he has any interest or relationship directly or indirectly. If an interested person suggests that a member should disqualify himself in a particular matter because of bias or prejudice, the member shall be the judge of his own qualification.

17 C.F.R. § 200.60.

The Commission's Regulation Concerning Conduct of Members and Employees and Former Members and Employees of the Commission, 17 C.F.R. §§ 200.735-1 *et seq.*, sets forth the standards of ethical conduct required of Commission members and current and former employees of the SEC (hereinafter, referred to collectively as "employees"). The Conduct Regulation states in part:

> The Securities and Exchange Commission has been entrusted by Congress with the protection of the public interest in a highly significant area of our national economy. In view of the effect which Commission action frequently has on the general public, it is important that . . . employees . . . maintain unusually high standards of honesty, integrity, impartiality and conduct. . . .

17 C.F.R. § 200.735-2.

RESULTS OF THE INVESTIGATION

I. Background

A. The Securities Investor Protection Corporation and Act

Congress created SIPC in the Securities Investor Protection Act of 1970 ("SIPA") to provide protection against losses to customers from the failure of a securities firm. 15 U.S.C. § 78ccc(a)(1); H.R. Rep. No. 91-1613, 5255 (1970). SIPA's purpose was to establish a reserve fund that would provide protection to customers of broker-dealers and to reinforce investors' confidence in the securities industry. H.R. Rep. No. 91-1613, 5257 (1970). It is a nonprofit corporation and is not "an agency or establishment of the federal government." 15 U.S.C. § 78ccc(a)(1). SIPA provides that all broker-dealers who are required to register as brokers or dealers under Section 15(b) of the Securities Exchange Act of 1934 shall be members of SIPC, with certain limited exceptions as specified in the statute. *Id.* § 78ccc(a)(2). SIPC is required to establish a SIPC Fund into which it deposits all monies it receives as membership fees. *Id.* § 78ddd(a)(1) and (c). If the SIPC Fund is, or reasonably appears to be, insufficient, the SEC may make loans to SIPC by issuing notes or obligations to the Secretary of the Treasury in an aggregate amount not to exceed $2.5 billion. *Id.* § 78ddd(g) and (h).

SIPC's role is to restore funds to investors who have assets at bankrupt or financially troubled brokerage firms. It does so by working with a court-appointed trustee (or acting as the trustee itself) in court proceedings to carry out a liquidation of a brokerage firm, including reviewing claims of the brokerage's customers and distributing property to the customers. If it receives notice that a member has failed or is in danger of failing to meet its obligations to customers, SIPC may bring an application in a court of competent jurisdiction for a protective decree to institute a liquidation proceeding. *Id.* § 78eee(a)(3)(A). Upon receipt of the application, the court must issue a protective decree if the debtor consents to or fails to contest the application, or if certain other conditions are met.[2] *Id.* § 78eee(b)(1). If the court issues the protective decree, it then appoints the trustee for the liquidation (and the trustee's counsel) that SIPC has the sole discretion to specify.[3] *Id.* § 78eee(b)(3). When it has issued the decree and appointed the trustee, the court must order the removal of the proceeding to the bankruptcy court for that jurisdiction. *Id.* § 78eee(b)(4).

SIPA specifies the powers of a SIPA trustee. 15 U.S.C. § 78fff-1(a). Most

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[2] SIPC may also bring such an application for a protective decree in certain other circumstances, such as if it receives notice that a member is unable to meet its obligations as they mature; that a member is the subject of a proceeding pending in which a receiver has been appointed; or that a member is not in compliance with the requirements of the Securities Exchange Act of 1934 or the rules of the SEC or any applicable self-regulatory organization. 15 U.S.C. § 78eee(b)(1). In such circumstances, the court must grant such a SIPA application. *Id.*

[3] SIPA also sets forth the circumstances under which SIPC or its employee can serve as the trustee. *Id.*

notably, SIPA incorporates certain aspects of the federal bankruptcy code and provides that a SIPA trustee has "the same powers and title with respect to the debtor and the property of the debtor, including the same rights to avoid preferences, as a trustee in a case under title 11." *Id.* The statute states:

> Whenever customer property is not sufficient to pay in full the claims . . . , the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of title 11. Such recovered property shall be treated as customer property.

Id. § 78fff-2(c)(3). Accordingly, a SIPA trustee may, among other things, bring preference actions to avoid any transfer of property of the debtor that was transferred within 90 days of the filing of the liquidation proceeding and to avoid any transfer of property of the debtor that was made or incurred on or within two years before the date that the liquidation proceeding was filed. 11 U.S.C. §§ 547(b)(4), 548. Additionally, a trustee may bring fraudulent conveyance actions under state law, which usually provides a longer statute of limitations than the two-year federal limit.[4] *Id.* § 544(b); *e.g.*, N.Y.C.P.L.R. § 213(8).

The trustee is also responsible for publication and mailing of a notice of the commencement of a liquidation proceeding. 15 U.S.C. §78fff-2(a)(1). The trustee must mail such notice to "each person who, from the books and records of the debtor, appears to have been a customer of the debtor with an open account within the past twelve months." *Id.* The trustee then receives written statements of claims that customers file during a time period determined by statute or court order. *Id.* § 78fff-2(a)(2).

After receiving such a written statement of claim, the trustee shall "promptly discharge . . . all obligations of the debtor to a customer relating to, or *net equity* claims based upon, securities or cash, by the delivery of securities or the making of payments to or for the account of such customer . . . insofar as such obligations are ascertainable from the books and records of the debtor or are otherwise established to the satisfaction of the trustee."[5] 15 U.S.C. § 78fff-2(b) (emphasis added). SIPA defines "net equity" as:

> the dollar amount of the account or accounts of a customer, to be determined by -- (A) calculating the sum which would

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[4] For purposes of this Report, we will use the term clawback suits to apply to preference actions, fraudulent conveyance actions, and all other avoidance actions.

[5] In order to effectuate this power and be able to make payments to customers, the court authorizes the trustee to satisfy customer claims from money made available to the trustee by SIPC. 15 U.S.C. § 78fff-2(b). SIPC is required to make advances from the SIPC Fund to the trustee for payment of customer claims. *Id.* § 78fff-3.

> have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date -- all securities positions of such customer . . . minus (B) any indebtedness of such customer on the filing date. . . .

Id. § 78lll(11). Accordingly, the question of what constitutes a customer's net equity is central to determining the appropriate amount that each customer will receive.

B. The SEC's Oversight of SIPC

The SEC has significant authority over SIPC. *See, e.g., SIPC v. Barbour*, 421 U.S. 412, 417 (1975) (under SIPA, SEC has "plenary authority to supervise the SIPC") (internal quotation omitted). SIPC must provide the Commission with a written report of its business as soon as practicable after the close of each fiscal year, including financial statements setting forth SIPC's financial position and results of its operations (including the source and application of its funds). 15 U.S.C. § 78ggg(c)(2). The SEC may also make certain examinations and inspections of SIPC and require SIPC to provide certain reports or records that it considers necessary or appropriate in the public interest. *Id.* § 78ggg(c)(1); *see also* Sr. TM Official Testimony Tr. at 17. Further, in the event that SIPC refuses to commit its funds or otherwise act for the protection of its members' customers, the SEC can bring an action in federal district court for an order requiring SIPC to discharge its statutory obligations. *Id.* § 78ggg(b). Under SIPA, the SEC is permitted to, on its own motion, file a notice of appearance in a SIPA liquidation and "may thereafter participate as a party." *Id.* § 78eee(c).

SEC regulations provide that SIPC oversight falls within the responsibility of the SEC's Division of Trading and Markets ("TM"). 17 C.F.R. § 200.19a.[6] Sr. TM Official testified that he considers TM the SEC's "primary liaison with SIPC." Sr. TM Official Testimony Tr. at 16; *see also* Gallagher Interview Tr. at 7 (TM "generally oversees the day-to-day business of SIPC."). In the past several years, as SIPC's responsibilities have increased with the ongoing Madoff Liquidation and Lehman Brothers bankruptcy proceedings, its place within TM's portfolio has grown. Gallagher Interview Tr. at 7. TM's oversight role includes regular conversations with SIPC staff about case status, TM attendance at SIPC Board meetings, and correspondence with SIPC regarding various items such as the amount available in the SIPC Fund and the status of different cases. Sr. TM Official Testimony Tr. at 16.

OGC Assistant General Counsel #1 was the OGC attorney who oversaw the Commission's bankruptcy litigation (of which SIPA proceedings were a part). OGC Assistant General Counsel #1 Testimony Tr. at 13. She testified that TM had the primary role in SIPC oversight within the Commission. *Id.* at 19. OGC Assistant General Counsel #1 stated that because TM's SIPC oversight role was specified in the Code of

[6] This regulation refers to the predecessor of the Division of Trading and Markets, which was the Division of Market Regulation.

Federal Regulations, she tried to be respectful of that role. *Id.* at 17-18. OGC plays a role in the SEC's oversight of SIPC, however, when there is a SIPC liquidation or litigation or when questions of statutory interpretation arise because of OGC's expertise in bankruptcy law.[7] Sr. TM Official Testimony Tr. at 17-18; Gallagher Interview Tr. at 7. OGC Assistant General Counsel #1 stated that whenever someone raised a SIPA issue with her, she would contact Michael Macchiaroli, a TM Associate Director, or Sr. TM Official to discuss and determine how to handle the issue. OGC Assistant General Counsel #1 Testimony Tr. at 18-19.

C. The Madoff Liquidation

On December 15, 2008, the United States District Court for the Southern District of New York granted SIPC's motion for a protective decree that BMIS customers were in need of the protections available under the SIPA. Order, Docket No. 4, *SIPC v. BMIS*, Case No. 08-10791, *at* http://madofftrustee.com/CourtFilings.aspx. The court also appointed Irving H. Picard as Trustee for the Madoff Liquidation and the law firm of Baker & Hostetler LLP as counsel to Mr. Picard. *Id.* at 2. The order also removed the proceeding to the United States Bankruptcy Court for the Southern District of New York. *Id.* at 6.

Pursuant to the Trustee's application, on December 23, 2008, the bankruptcy court entered the Housekeeping Order, which addressed the publication and mailing of a notice of the commencement of the Madoff Liquidation. Ex. 42. The court's order directed that both these events occur on or before January 9, 2009. *Id.* On or about January 2, 2009, the Trustee caused the required publication of the notice and mailed notice of the proceeding to customers and creditors, advising potential claimants of the deadlines for filing claims. *See* Ex. 43. The mailing went to over 16,000 potential claimants, including all persons and entities that, based on BMIS records, appeared to be or have been a customer of BMIS at any time. *Id.*

As discussed further in Section IV.D *infra*, the Trustee continues to administer the Madoff Liquidation.

II. From the Outset, the SEC Played a Substantive Role in the Madoff Liquidation

A. As Early As December 2008, the SEC Began to Discuss Madoff Liquidation Issues with SIPC

Almost immediately after Madoff's December 11, 2008 confession was reported, the SEC began working with SIPC on matters related to Madoff. Stephen Harbeck, the President and CEO of SIPC, stated that Sr. TM Official had called him shortly after the

[7] NYRO Assistant Regional Director also had a role in interpreting SIPA issues. Sr. TM Official Testimony Tr. at 18.

confession stating that there had been a massive fraud at Madoff's brokerage firm, which triggered an immediate and cooperative response between SIPC, TM, and the SEC's New York Regional Office, and resulted in filing the Madoff Liquidation. Harbeck Interview Tr. at 12-13. SEC staff also recalled that the SEC and SIPC began working together almost immediately after Madoff confessed. Consistent with Harbeck's recollection, Macchiaroli testified that the SEC staff called SIPC almost immediately after learning about Madoff's scheme and before the December 24, 2008 e-mail discussed below. Macchiaroli Testimony Tr. at 18-20. Sr. TM Official also recalled that SIPC was involved "from day one" and "agreed to go in immediately because [SIPC] could see the need for that. But their next question was how -- they wanted to coordinate with the Commission on how the claims should be processed." Sr. TM Official Testimony Tr. at 18-19.

Shortly after discussions between SIPC and the SEC began, SIPC expressed its desire to reach a position quickly and to have the SEC and SIPC present a unified position. The need to speak with one voice was particularly important to SIPC because in a previous instance, SIPC believed that it had proceeded in accordance with its view of the law, and the SEC entered the case at the appellate level and took a position contrary to SIPC's.[8] Harbeck Interview Tr. at 13-14. Harbeck did not want such a situation to recur and, therefore, "wanted to make sure that SIPC and the SEC agreed on a methodology." *Id.* at 14. In addition, the need to act quickly was particularly important because SIPC and the Trustee would have to start paying customer claims "very, very soon." *Id.* at 17. The Trustee agreed that he wanted to obtain consensus from the SEC as soon as possible because the claims process was starting "right after New Year's." Picard Interview Tr. at 16-17. He explained, "Publication of our notice [announcing the commencement of the Madoff Liquidation] was January 2, 2009, which meant within days we would start getting claims, and hopefully start processing claims. It would be very helpful if we were all on the same page doing it." *Id.* at 17. Accordingly, on December 20, 2008, Harbeck sent an e-mail to Macchiaroli, stating: "I want to go into the claims process in Madoff with the SEC and SIPC speaking with the same voice as to what claimant should receive. Most specifically, I do NOT want the situation that occurred in the New Times case to be repeated." Ex. 44. He also asked for a meeting with the Commission "on an expedited basis." *Id.*

The SEC understood that SIPC wanted to reach agreement on a position quickly. Macchiaroli explained to the OIG as follows:

> There had been a time where the Commission took a view years ago opposite to what [Harbeck] thought would be the Commission position. And so he always feared that that would happen, all of a sudden that the Commission would

[8] In that case, the SEC did not participate in the district court proceeding, but filed a brief in the Second Circuit taking a position different from SIPC's, and the Second Circuit adopted the SEC's position. *See In re New Times Secs. Servs., Inc.*, 371 F.3d 68, 76, 83-87 (2d Cir. 2004).

> reverse courses on what he thought the Commission's position was, and then suddenly they would change the position for whatever reason.
>
> So that was something that concerned him because he didn't want to be in effect exposed taking a position and find out that the Commission was opposing it. So he wanted to be sure he understood the Commission's positions and his preference was that there be general agreement on what those positions were.

Macchiaroli Testimony Tr. at 45-46. Similarly, Sr. TM Official testified:

> Q. Was SIPC concerned the Commission might not support it?
>
> A. Yes. . . . Because they hadn't taken a formal vote or filed a claim, he thought that there is a the [*sic*] risk to SIPC that they might take a different view, even though SIPC started to pay claims out or had taken a position in court.
>
> Q. So it was very important for SIPC that the Commission approve of what they were doing[?]
>
> A. Yes.

Sr. TM Official Testimony Tr. at 42. NYRO Assistant Regional Director recalled similar conversations with Harbeck, stating, "It must have been before [January 8, 2009], at about the time that the FBI took over and sitting with Steve Harbeck. And at that time . . . he said to me you guys have to come up with a position quickly." NYRO Assistant Regional Director Testimony Tr. at 16.

On December 24, 2008, Harbeck sent another e-mail to Macchiaroli and Sr. TM Official describing "issues SIPC and the SEC will face immediately in the Madoff case." Ex. 45. The e-mail set forth various scenarios in which a determination would have to be made as to a claimant's net equity. *Id.* It also stated:

> But we need to also deal with the possible claimant who has withdrawn <u>more</u> than his original deposit, but has a statement reflecting significant existing securities positions. Other claimants who were not so lucky will want us to (a) deny any claim for such a person and (b) seek contribution from such a person. But how long to reach back under 78fff-2(c)(3), the Bankruptcy Code, and state law?

Id. (emphasis in original). When discussing this e-mail with the OIG, Harbeck confirmed that even from the beginning, just days after Madoff confessed, the issue of clawbacks was something that was discussed and at issue between SIPC and the SEC, explaining: "[Y]ou cannot separate the correct calculation of claims, the constitution of the corpus of assets known as customer property, and the concept of clawback. It is all of one -- you must treat it as a cogent whole." Harbeck Interview Tr. at 16.

B. SIPC and the Trustee Advocated the Money In/Money Out Method of Determining Customer Net Equity

From the outset of the Madoff Liquidation, SIPC consistently supported an approach to net equity based on the difference between a customer's initial investment, *i.e.*, his principal, and any amounts withdrawn from the account over time, which was the Money In/Money Out Method.[9] Accordingly, a Madoff investor would be able to make a net equity claim for the amount that he initially invested, less any amounts that he withdrew over time. On January 7, 2009, personnel from both TM and OGC met with Harbeck and others from SIPC. Harbeck Interview Tr. at 14; OGC Assistant General Counsel #1 Testimony Tr. at 22, 52; *see* also Macchiaroli Testimony Tr. at 25; Ex. 46. In preparation for that meeting, TM drafted a set of questions that were likely to come up in the Madoff Liquidation. Ex. 46 at 2-3; Macchiaroli Testimony Tr. at 23. Those questions included the calculation of a customer's net equity and "[w]hat property, if any, should SIPC seek to recover under Section 78fff-2(c)(3), [SIPA's] clawback provision?" Ex. 46 at 2-3. The sub-categories under the latter issue stated: "a. If property should be recovered, how far back should the recovery go? b. If property should be recovered, should only those customers who have withdrawn more money than their initial deposits be targeted? c. The trustee has broad powers to recover property that should be part of the fund of customer property." *Id.* at 3.

The questions presented also referenced and attached a contemporaneous memorandum prepared by OGC Assistant General Counsel #1 at TM's request. *Id.*; OGC Assistant General Counsel #1 Testimony Tr. at 20-21; *see also* Macchiaroli Testimony Tr. at 24; Sr. TM Official Testimony Tr. at 23-24. The memorandum stated that, among other things, the Trustee has "broad authority [to bring clawback actions] to recovery [*sic*] property that should be part of the fund of customer property but has been transferred by the debtor." Ex. 46 at 4. OGC Assistant General Counsel #1 testified that her memorandum covered "what is the trustee's authority," and explained that "basically Section 8(c)(3) [the clawback provision], to the extent there is insufficient money in the fund of customer property allows the trustee to bring the avoidance actions that are available to trustees under the bankruptcy code." OGC Assistant General Counsel #1 Testimony Tr. at 27-28. Thus, even at this early stage of working with SIPC, the SEC

[9] The Money In/Money Out Method is also referred to as the cash in/cash out method.

understood that one of the primary issues to address in the Madoff Liquidation concerned clawbacks.[10]

At the January 2009 meeting between the SEC and SIPC staff, SIPC presented the principles that it and the Trustee had formulated to govern the payment of customer claims, including the treatment of clawbacks and the determination of net equity. Ex. 48; Harbeck Interview Tr. 16-17, 19, 21-22; *see also* OGC Assistant General Counsel #1 Testimony Tr. at 22-23. These principles set forth SIPC's net equity position: "A customer's net equity claim should be determined by computing the amount of money the customer deposited with BMIS from the initial opening of the customer's account forward ('principal') less any money withdrawn by the customer during that period." Ex. 48 at 1. SIPC's principles also addressed clawbacks: "Legal remedies to require customers to return money withdrawn from BMIS should be used by the Trustee as follows. . . . For withdrawals by any customer made within the fraudulent conveyance statute of limitations (generally up to six years), the trustee only will seek a return of fictitiously reported interest, dividends, and gains (*i.e.*, the trustee will not seek a return of principal)." *Id.* at 1-2 (emphasis in original). During that meeting, Harbeck again stressed the need for agreement between the SEC and SIPC. OGC Assistant General Counsel #1 Testimony Tr. at 22 ("Harbeck, in particular, was concerned that the Commission and SIPC should be on the same side."); Harbeck Interview Tr. at 16-17.

Shortly after the initial meeting with SIPC staff, TM circulated an Information Memorandum to the Commission regarding the Madoff Liquidation, copied to, among others, OGC.[11] Ex. 49. The memorandum noted that the liquidation "will raise a number of issues relating to . . . how customer claims should be satisfied given that transactions and positions shown on customer account statements were fictitious and that many customers withdrew funds from BMIS over the years based on fictitious interest, dividends and gains." *Id.* at 2. It also stated: "After the net equity of each customer is determined, SIPC will then need to decide how much customer property is available for distribution. [SIPA's] 'clawback' provision . . . gives trustees broad authority to recover property that should be part of the fund of customer property." *Id.* at 4-5. The Information Memorandum further noted SIPC's desire to agree on a position quickly, stating: "SIPC would like to quickly reach a consensus with the Commission on these issues to expedite its processing of customer claims." *Id.* at 2.

On January 15, 2009, the Commission considered the January 13, 2009 Information Memorandum in a closed Executive Session, attended by TM Deputy

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[10] OGC Assistant General Counsel #1 later circulated a final version of this memorandum. Ex. 47. Her cover e-mail concluded: "The bottom line is that the SIPA Trustee should be able to recover payments for both earnings and principal made within two years of the bankruptcy and payments for earnings made within six years of the bankruptcy." *Id.*

[11] All four Commissioners testified that they generally recalled receiving these types of memoranda related to the Madoff Liquidation, and that they or someone on their staff would have reviewed these memoranda. Aguilar Testimony Tr. at 13, 15; Casey Testimony Tr. at 8; Paredes Testimony Tr. at 8; Walter Testimony Tr. at 10, 13-14.

Director Daniel Gallagher, Macchiaroli, Sr. TM Official, and OGC Assistant General Counsel #1. Ex. 50. The minutes of this session stated:

> The staff briefed the Commission on the current status of the SIPC liquidation in the Madoff matter. . . . Issues that will take more time to resolve include whether to attempt to "claw back" phony interest accrued and paid out in earlier redemptions. Staff said that they were reluctant to sue customers for return of redeemed funds, and that clawbacks could disadvantage those with few withdrawals. SIPC, however, would like to pursue clawbacks. . . . Right now, SIPC is seeking Commission approval for their approach, including seeking clawbacks. The staff is prepared to provide views on the first tranche payouts to recent investors who made no withdrawals and will continue to analyze the more complicated issues.

Id. at 1. A few weeks later, Gallagher attended a SIPC Board meeting and provided an e-mail summary of that meeting: "SIPC is eager to get Commission feedback on their proposed paradigm for paying customer claims and, importantly, clawing back money that was withdrawn by investors. I informed the Board that we briefed the Commission on SIPC's proposal. . . ." Ex. 51; Gallagher Interview Tr. at 12. Gallagher recalled that SIPC was pushing for the Commission to determine its approach, and that before SIPC started paying BMIS investors, it "wanted feedback on the Commission's view of their proposal." Gallagher Interview Tr. at 12-13.

On February 11, 2009, TM circulated a second Information Memorandum to the Commission regarding the Madoff Liquidation, copied to, among others, OGC. Ex. 52. The memorandum stated that SIPC had proposed a set of principles for handling customer claims. *Id.* at 2. These principles were consistent with those SIPC presented at the January 7, 2009 meeting and set forth the same Money In/Money Out Method of calculating net equity and the same approach to seeking clawbacks from any customer who made withdrawals during the applicable statute of limitations period. *Id.*; *compare to* Ex. 48. TM stated that it believed that it would be appropriate for SIPC to begin using the Money In/Money Out Method to pay claims for those customers who opened their accounts within the last year and had not made any withdrawals, but noted that "by calculating the amount of the claims using the money-in/money-out principle, the trustee would be committing to a claims determination process that does not recognize fictitious interest, dividends, and gains (collectively 'returns') shown on account statements provided to customers." *Id.* at 2-3. The memorandum also included a section addressing "The Use of Avoidance Actions by the SIPC Trustee," which described the applicable provisions of the bankruptcy code and SIPA. *Id.* at 5. It stated: "The SIPC trustee has agreed to exercise a degree of discretion and not bring these actions in every instance. In

particular, the trustee has reserved the right to seek to recover withdrawals of fictitious returns within the six year statute of limitations by any customer."[12] *Id.*

On February 12, 2009, the Commission considered the February 11, 2009 Information Memorandum in a closed Executive Session, attended by former TM Director Erik Sirri, Macchiaroli, Sr. TM Official, OGC Assistant General Counsel #1, and NYRO Assistant Regional Director. Ex. 54. The minutes of the session stated:

> The Staff briefed the Commission on the current status of the SIPC liquidation in the Madoff matter. Mr. Sirri said that SIPC would like to begin payouts with 11 payees who had not withdrawn any money based on the 3 principles outlined in the information memorandum. SIPC would like for the staff to not object to their action. The Commission and staff discussed the principles and possible inequities.

Id. at 1. The Commission asked that the staff raise two questions with SIPC regarding the clawback of a SIPC advance and the timeframe of planned payouts. *Id.* A few days after this meeting, TM circulated responses from SIPC to these two questions, which Gallagher forwarded to Chairman Schapiro. Ex. 55.

C. The SEC's Initial Consideration of Issues in the Madoff Liquidation Included Clawbacks

From the beginning, the issues presented by the Madoff Liquidation and considered by the Commission included clawbacks. All four Commissioners recalled that at least part of the issues that were before the Commission in the January and February 2009 timeframe involved clawbacks. Aguilar Testimony Tr. at 14, 16; Casey Testimony Tr. at 9, 11; Paredes Testimony Tr. at 9; Walter Testimony Tr. at 11, 12, 13-14. Chairman Schapiro, however, did not recall being focused on clawbacks at that time. Schapiro Testimony Tr. at 22.

TM also recalled that clawbacks were part of the Madoff Liquidation analysis. Sr. TM Official acknowledged that from the outset, clawbacks were part of the issues that SIPC and the SEC would have to consider as part of the Madoff Liquidation. Sr. TM Official Testimony Tr. at 21-22, 23. He also agreed that he and others in the SEC determined quickly that in order for investors to have recovery in this case, there would need to be clawbacks, and then the SEC considered issues of how clawbacks would work, such as who would be subject to clawbacks, under what circumstances, and for what

[12] On the same date as this Information Memorandum, OGC Assistant General Counsel #1 circulated an additional draft memorandum to TM personnel regarding certain principles that she understood TM was recommending to govern decisions on claims determinations and avoidance actions. Ex. 53. These principles included the Money In/Money Out Method and the concept that "[t]he SIPA Trustee may, in his discretion, bring actions to recover payments that exceeded the amount of principal invested – *i.e.*, fictitious earnings." *Id.* at 2.

amount. *Id.* at 24. Similarly, Gallagher recalled that one of the issues that the Commission was considering was clawbacks, including "how far back [clawbacks] would go." Gallagher Interview Tr. at 16.

In addition, OGC Assistant General Counsel #1 of OGC also understood that clawbacks were part of the discussion. She described one of the "major issues" in the Madoff Liquidation as "what would the trustee do with respect to exercising avoidance powers to recover payments that had been made prior to the SIPA liquidation." OGC Assistant General Counsel #1 Testimony Tr. at 21. She agreed that consideration of clawbacks was part of the SEC's work with respect to the Madoff Liquidation and testified, "It was important for the Commission to know that the trustee had the authority to bring the avoidance actions." *Id.* at 21-22.

As discussed above, SIPC viewed clawbacks as part of the issues considered by SIPC and the SEC from the beginning of the Madoff Liquidation. Harbeck testified that at the January 2009 meeting between SIPC and SEC staff, SIPC wanted to discuss how one treated the correct calculation of claims, the constitution of customer property, and the concept of clawback "as a cogent whole." Harbeck Interview Tr. at 16. Accordingly, at the January meeting, Harbeck stated that if the Commission did not agree to its proposed methodology, it could not simply reject the theory, but it had to come up with a "cogent, unified theory that fit the law" and could not simply reject pieces of the proposal. *Id.* at 16-17. The SIPC principles included an approach to clawbacks "because you cannot separate the correct calculation of the claim from what is owed in terms of a preference or a fraudulent transfer." *Id.* at 21. SIPC's view was that the SEC understood the fact that "it was all one process" and that the net equity definition would affect clawbacks. Harbeck explained:

> There is no question they understood it. Look at the principles in the discussion that -- look at the e-mail I sent on the first days. We were discussing the fact that you had to take into consideration fraudulent transfers and preferences as to reach an accurate number. There is no other way to do it.

Id. at 50.

D. The SEC Reached Consensus As to The Money In/Money Out Method

On February 19, 2009, Chairman Schapiro met with SIPC Chairman Armando Bucelo, General Counsel Josephine Wang, and Harbeck.[13] Harbeck Interview Tr. at 22. Gallagher also attended the meeting. Gallagher Interview Tr. at 17. Harbeck stated that during that meeting, "Chairman Schapiro indicated that three, and possibly four, of the commissioners were in agreement with the methodology and that all divisions of the Commission had likewise agreed that our methodology was correct at law." Harbeck Interview Tr. at 22. At this point in time, a few days before Becker rejoined the SEC, Harbeck "understood that the Commission was set with going forward with the method that [SIPC] had proposed," *i.e.*, the Money In/Money Out Method. *Id.* at 23. Gallagher stated that at this point, the Commission did agree with the general outline of the SIPC principles with regard to net equity, but that it wanted additional time to consider the various issues associated with clawbacks. Gallagher Interview Tr. at 23-25.

Harbeck again emphasized the need for SIPC and the SEC to agree on a position on these issues and explained how he did not want a situation like that which occurred in the *New Times* case to occur again. Harbeck Interview Tr. at 22; *see also* Gallagher Interview Tr. at 19-20. Harbeck stated that Gallagher assured him this would not happen. Harbeck Interview Tr. at 22. Gallagher stated that would be consistent with something he would say, but that he could not make any promises to Harbeck. Gallagher Interview Tr. at 20.

During a SIPC Board meeting the following day, Harbeck reported on the meeting with Chairman Schapiro. In the Board meeting, Harbeck informed the Board that he had discussed both the proposed methodology for resolving claims and the Trustee's intent to exercise discretion in deciding which clawback actions to seek under the relevant laws. Ex. 57 at 1-2. Harbeck recalled briefing the SIPC Board as to "the fact that we had met with Chairman Schapiro and . . . that the proposed methodology for resolving claims with Madoff was discussed and that the Chairman of the SEC indicated that she and most of the commissioners, but not all, agreed on the methodology." Harbeck Interview Tr. at 23.

Around this timeframe, TM also had determined that the Money In/Money Out Method was the appropriate method for determining net equity.[14] Sr. TM Official testified that TM initially determined that the Money In/Money Out Method was the

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[13] Chairman Schapiro did not specifically recall attending the meeting, but contemporaneous documents and the statements of other witnesses indicate that she did. *See, e.g.*, Gallagher Interview Tr. at 17; Harbeck Interview Tr. at 22; Ex. 56; Schapiro Testimony Tr. at 23.

[14] On May 13, 2009, OGC Assistant General Counsel #1 discussed the Money In/Money Out Method in an e-mail to NYRO Assistant Regional Director and stated, "TM has already blessed the Trustee's approach and the Commission was informed of it at the meeting back in March." Ex. 58; OGC Assistant General Counsel #1 Testimony Tr. at 46-47.

appropriate methodology and agreed that from TM's perspective, any subsequent change from the Money In/Money Out Method was a change from the original approach. Sr. TM Official Testimony Tr. at 43, 68. Gallagher similarly recalled that with respect to the Money In/Money Out Method, TM was "on board much earlier than" the February 2009 timeframe and had supported this approach "[e]ver since the first Commission briefing." Gallagher Interview Tr. at 28. Macchiaroli testified that the SIPC principles, including the Money In/Money Out Method, were not different from TM's thinking at that time. Macchiaroli Testimony Tr. at 32.

Harbeck sent a letter to Gallagher on February 26, 2009 to summarize SIPC's understanding of the items that were discussed and conclusions reached during the February 19, 2009 meeting. Ex. 56. The letter stated: "After discussing [the SIPC principles], it was communicated during the meeting with Chairman Schapiro that a majority of the Commissioners agreed to this general outline, but that, in light of the Commission's desire to act by unanimous consensus in most instances, a bit more discussion was necessary." *Id.* at 3. Harbeck stated that as of this time, he understood that the Commission was set with going forward with the method SIPC had proposed, the Money In/Money Out Method. Harbeck Interview Tr. at 23. Chairman Schapiro testified that she had no reason to dispute what Harbeck had said in this letter to Gallagher, and Gallagher did not recall believing that the letter mischaracterized anything. Schapiro Testimony Tr. at 26; Gallagher Interview Tr. at 22.

On March 10, 2009, Harbeck sent another letter to Sirri, then TM's Director, with a copy to Becker, Gallagher, and Macchiaroli. Ex. 59. That letter again set forth the principles with which SIPC and the Trustee proposed to review, determine, and satisfy customer claims. *Id.* at 2-3. The letter stated: "During a telephone conversation on March 6, 2009, members of your staff indicated that the Division of Trading and Markets concurs in the principles as set forth above. SIPC takes great comfort in that concurrence. Representatives of the General Counsel's Office attended and participated in the earliest meeting between our respective organizations on this subject."[15] *Id.* at 3.

III. Becker Returned to the Commission Late in February 2009 and Disclosed His Interest in a BMIS Account to Chairman Schapiro

A. Becker Joined the Commission as General Counsel and Senior Policy Director in February 2009

Becker served as the Commission's General Counsel during two separate time periods. He initially served as Deputy General Counsel from October 1998 through December 1999 and as General Counsel from January 1, 2000 through May 2002.[16] On

[15] Indeed, OGC Assistant General Counsel #1 recalled attending the January 2009 meeting with SIPC. OGC Assistant General Counsel #1 Testimony Tr. at 22.

[16] *See* Becker Testimony Tr. at 8-10; SEC Press Release No. 99-166, *David Becker Named General Counsel* (Dec. 7, 1999), http://sec.gov/ news/press/pressarchive/1999/99-166.txt; SEC Press Release No. 98-118, *David Becker and Meyer Eisenberg Named Deputy General Counsels* (Oct. 29, 1998),

February 6, 2009, the Commission announced that Becker would rejoin the Commission as its General Counsel and Senior Policy Director. SEC Press Release No. 2009-20, *David M. Becker Named SEC General Counsel and Senior Policy Director* (Feb. 6, 2009), http://sec.gov/news/press/2009/2009-20.htm; *see also* Becker Testimony Tr. at 10-11. Becker began his second tenure with the Commission on February 23, 2009. Ex. 60. Becker testified that at the time that he agreed to return to the SEC, he told Chairman Schapiro that he "did not see [himself] doing it for longer than two years." Becker Testimony Tr. at 11. The Chairman testified that she understood that Becker was making a limited commitment in terms of timing, although she could not recall whether the commitment was specifically for two years.[17] Schapiro Testimony Tr. at 8; *see also* Cahn Testimony Tr. at 11-12 (Becker "mentioned to me that he didn't expect to stay at the Commission longer than a couple of years.").

In her testimony, Chairman Schapiro noted that the SEC faced a significant number of challenges around the time that she hired Becker:

> The agency was really reeling is, I think, a fair way to describe it. The failure of Lehman Brothers and Bear Stearns and the Consolidated Supervised Entity Program. . . Madoff had been – had confessed and been arrested . . . maybe two months before I arrived.
>
> There were vacancies at the senior levels. Morale was not great. There were just lots and lots of issues that permeated the agency at that time.

Schapiro Testimony Tr. at 8. [redacted] The SEC was trying to address issues from previous Inspector General reports that needed to be resolved, and the SEC faced questions as to the appropriateness of its overall structure. *Id.* at 13-14.

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Chairman Schapiro "[a]bsolutely" agreed that one of the biggest issues facing the SEC at that point was Madoff. *Id.* at 8-9. In particular, the Chairman wanted to

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http://sec.gov/news/press/pressarchive/1998/98-118.txt; SEC Press Release No. 2002-51, *Giovanni Prezioso Named SEC General Counsel* (April 3, 2002), http://sec.gov/news/press/2002-51.txt. After his first tenure at the Commission, Becker returned to private law practice. Becker Testimony Tr. at 10.

[17] Indeed, on February 1, 2011, the Commission announced that Becker was leaving the Commission at the end of the month. SEC Press Release No. 2011-34, *SEC General Counsel David Becker to Leave Commission* (Feb. 1, 2011), http://sec.gov/news/ press/2011/2011-34.htm. The OIG investigation found that this announcement preceded Becker's knowledge of the clawback suit against him based upon his mother's estate's BMIS account. *See* Section VII *infra*. The last day of Becker's second tenure at the Commission was February 25, 2011. Becker Testimony Tr. at 11; Ex. 60. Becker testified that the clawback suit had nothing to do with his departure from the SEC. Becker Testimony Tr. at 11.

determine what aspects of the examination and enforcement programs had allowed the SEC to miss Madoff's Ponzi scheme over such a long period of time and whether there were regulatory provisions that could improve the SEC's capabilities. *Id.* at 9. Becker also explained that when he returned to the Commission:

> It was certainly clear to me that what I'll call the Madoff event was very significant in the Commission's history, had been a body blow to the Commission, and that one of the things that I wanted to do was to help the Commission through this time and use what we learned from it to strengthen the Commission.

Becker Testimony Tr. at 26.

B. Around the Time that Becker Returned to the Commission, He and Chairman Schapiro Discussed His Mother's BMIS Account

Both Becker and Schapiro recalled that, around the time of his return, Becker discussed his mother's estate's BMIS account with Chairman Schapiro.[18] Becker testified that he principally recalled the fact of the conversation. Becker Testimony Tr. at 24. He testified: "I recall, I believe, that I told her that I just learned that my mother had had an account with Madoff. And other than that, . . . I believe I told her, because this would have been the only point of telling her this, that I had inherited some of the proceeds of that account. . . . I may have told her that the money was used to pay estate taxes." *Id.* Becker also stated that he must have told the Chairman "that like everything else, I would consult with [SEC Ethics Counsel William] Lenox before I did anything with this . . . I'm sure I must have mentioned that to her." *Id.* at 25. He could not specifically recall when the conversation occurred, but stated that his "instinct" was that it was probably before he returned to the Commission, "because the whole point of [his] raising it with her is to let her know about something that she might consider significant."[19] *Id.* Becker also testified that his "guess" would be that he informed the Chairman that the account included about $2 million and that he was aware of the possibility of a clawback action, but he did not have a specific recollection of telling her either of these facts. *Id.* at 28-29.

Chairman Schapiro testified that she recalled a conversation with Becker regarding his mother's account, and she believed, but was not certain, that it was after he

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[18] Becker's February 2009 discussion of this account with the SEC Ethics Office is discussed at Section XI.C *infra*.

[19] Becker's testimony is generally consistent with his February 25, 2011 letter to Chairman Spencer Bachus of the House Committee on Financial Services, in which he stated that he recalled telling Chairman Schapiro either shortly before or after he returned to the SEC that his "mother's estate, of which [he] was a beneficiary, had included a Madoff account that had been liquidated years before Mr. Madoff confessed to operating a Ponzi scheme." Ex. 61 at 2.

returned to the Commission. Schapiro Testimony Tr. at 11-12. Chairman Schapiro recalled that during that conversation, Becker told her that "his mother had had an account at Madoff. She had died . . . five or six years before. The account had been liquidated, and really that's all." *Id.* at 12. Chairman Schapiro did not remember:

> whether [Becker] had told [her] in that conversation they had inherited any money out of that account. I had understood the account was closed, so I definitely did not understand that he had inherited the account. Whether he had inherited proceeds from the account, I honestly don't remember whether in that conversation he had told me that, certainly no dollar value or anything like that.

Id. She also did not recall knowing "whether it was an account that made money or lost money or is exactly the same as when it was opened." *Id.* at 12-13.

Chairman Schapiro did not recall asking Becker any questions after he told her about his mother's account. Schapiro Testimony Tr. at 13. She also did not recall whether Becker said anything about seeking advice from the Ethics Counsel regarding the account. *Id.* at 14-15. At that time, Chairman Schapiro did not consider Becker's personal financial gain "in any way, shape, or form" or whether he would be subject to a clawback action. *Id.* at 15. Indeed, Chairman Schapiro testified that she would have had Becker recused from the net equity determination if she had known he was potentially subject to a clawback suit or "understood that he had any financial interest in how this [was] resolved . . . ." *Id.* at 80.

At the time of her initial conversation with Becker around the time that he rejoined the Commission, Chairman Schapiro did not consider there to be any issue from an ethical perspective with respect to a potential appearance of impropriety because the account was his mother's, not his, and it seemed remote from "anything [the SEC was] dealing with at that moment." Schapiro Testimony Tr. at 17. Chairman Schapiro stated that Becker did not give her any indication that it was not remote.[20] *Id.* Chairman Schapiro recalled that Becker's tone during the conversation was "fairly matter of fact . . . ." *Id.* at 15.

IV. Becker and OGC Determined the Staff's Recommendation to the Commission on the Net Equity Issue

In May 2009, the Commission began to receive submissions from various groups of claimants who did not agree with the Money In/Money Out Method for determining customers' net equity. *See* Section IV.A *infra*. When these submissions started to arrive, OGC, and particularly Becker, began to take the lead in the consideration of this issue.

[20] Chairman Schapiro's testimony is consistent with other accounts she has provided of this conversation with Becker. *See* Exs. 62-64.

Macchiaroli testified that OGC's role in the net equity discussions was "substantial" after Becker rejoined the Commission. Macchiaroli Testimony Tr. at 42. NYRO Assistant Regional Director testified that at the end of the day, Becker's position was going to be the position taken by OGC. NYRO Assistant Regional Director Testimony Tr. at 81. OGC drafted the advice and information memoranda that the Commission considered when determining its position on the appropriate method of determining net equity. Conley Testimony Tr. at 35, 37-38.

Specifically, Gallagher explained that around the June 24, 2009 timeframe, OGC "took the lead in the analysis of the SIPC-Madoff payouts." Gallagher Interview Tr. at 42. Indeed, on June 2, 2009, Gallagher asked for a meeting with the Chairman to talk about the SEC's approach on SIPC's Madoff payouts, copying Becker on the e-mail request and stating that "David [Becker] may want to join." Ex. 65. Gallagher explained to Becker that the purpose of the meeting was to "make sure we are all on the same page as we seem to be changing direction from the paradigm the commission approved earlier this year." Ex. 65; Gallagher Interview Tr. at 36-37. Becker replied that he would be glad to join the meeting and also indicated that he "had thought that we were still talking about whether to do so [*i.e.*, change direction]."[21] Ex. 65. When discussing this e-mail with the OIG, Gallagher stated that he "recall[ed] thinking that there was potential to revisit some of what we had already presented to the Commission, and [he] wanted to make sure that everybody was on the same page." Gallagher Interview Tr. at 37. He also stated that he recalled "that there was just a discussion of reopening the discussions . . . . [and] that what [he] viewed as settled matters were being revisited . . . ." *Id.*

The Chairman agreed that it "[was] fair to say" that Becker was her "point person" on the Madoff Liquidation issues because these were technical statutory interpretations and "complex, detailed legal questions" in an area where she had no prior experience. Schapiro Testimony Tr. at 37. In the June 2009 timeframe, Chairman Schapiro had several e-mail exchanges with Becker regarding the status of the net equity discussions. For example, on June 2, 2009, Chairman Schapiro forwarded to Becker an e-mail from a SIPC Board member, to which he responded, "We won't suggest [the SEC's position] until we've heard everybody out and we're comfortable that we're taking into account prior history in a constructive way." Ex. 68. Also, on June 8, 2009, the Chairman forwarded to Becker a New York Times article regarding a Madoff customers' group and asked him "how did it go with the lawyers[.]" Ex. 69.

SIPC personnel also believed that OGC took the lead on these issues after Becker rejoined the Commission. Harbeck agreed that it was OGC taking the lead, as opposed to TM, and stated that on May 20, 2009, he informed SIPC's Board via e-mail as follows:

[21] Although neither the Chairman nor Gallagher recalled any specific details regarding that meeting, contemporaneous e-mails and calendar entries reflect that such a meeting occurred. Ex. 66; Ex. 67; Schapiro Testimony Tr. at 36; Gallagher Interview Tr. at 36-37.

> [N]otwithstanding the SEC's supposed support and agreement to a methodology for claim satisfaction in the Madoff case, we were asked to justify our position as a matter of law. Josephine Wang [SIPC General Counsel] did so in an extremely good letter to the SEC's Office of General Counsel last week.
>
> Now the staff of the Commission has come up with a less than fully formed alternative . . . [that] [t]hey are floating months after we implemented the money-in minus money-out methodology. From what we have been told orally, the alternative is not only not supported by SIPA, but in direct contradiction with the statute. I believe this is coming from the Office of the General Counsel. We will be meeting with the SEC staff on either Friday or ideally Tuesday to discuss this matter and possibly, preliminarily, respond to the alternative.

Harbeck Interview Tr. at 32-33; Harbeck Interview Mem. at 2. Wang agreed, stating that TM, at least initially, was SIPC's contact within the SEC, but that after Becker rejoined the SEC, OGC became SIPC's contact or at least became more vocal about its position. Wang Interview Tr. at 13. Wang also agreed that in meetings and phone calls with Becker, he was the leading voice or one of the leading voices for the SEC. *Id.* at 14.

A. The Commission Received Submissions from Former SEC Commissioner Nazareth and Others In Support of the Last Account Statement Method for Determining Net Equity

About two months after Becker's return to the SEC, Becker received a letter dated May 1, 2009 ("May 1 Letter") from various law firms on behalf of a group of similarly-situated clients who had accounts at the time that the Madoff fraud was discovered and BMIS failed and who would be protected by SIPC.[22] Ex. 70; Nazareth Interview Mem. at

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[22] The May 1 Letter did not name any specific clients and stated only that they wrote "on behalf of customers of [BMIS]." Ex. 70 at 1. At the time of the May 1 Letter, none of the firms who signed the May 1 Letter had entered an appearance or made a filing in the Madoff Liquidation. On November 12, 2009, Karen Wagner of Davis Polk & Wardwell filed a Notice of Appearance in the Madoff Liquidation on behalf of herself, Denis J. McInerney (who also signed the May 1 Letter), and others to represent Sterling Equities Associates, Arthur Friedman, Saul Katz, David Katz, Gregory Katz, Michael Katz, L. Thomas Osterman, Marvin Tepper, Fred Wilpon, Jeffrey Wilpon, Richard Wilpon, and Mets Limited Partnership. Ex. 71.

On November 13, 2009, Richard Schwed of Shearman & Sterling LLP filed a Notice of Appearance in the Madoff Liquidation on behalf of himself, Stephen Fishbein (who signed the May 1 Letter), and James L. Garrity, Jr. identifying the various Shearman clients on Exhibit A. Ex. 72. On November 13, 2009, Carole Neville of Sonnenschein Nath & Rosenthal, LLP filed an opposition on behalf of the "Sonnenschein Investors," who were listed on an exhibit to the opposition. Opposition and Exhibit A, Docket No. 784, *SIPC v. BMIS*, *at* www.madofftrustee.com/CourtFilings.aspx. On November 13, 2009, James Smith of

3. The first of the law firm signatories to the May 1 Letter was the law firm of Davis Polk & Wardwell, including, specifically, Annette Nazareth, who was a former SEC Commissioner and TM Director.[23] Ex. 70 at 14; Nazareth Interview Mem. at 1. The May 1 Letter advocated use of a method based upon a customer's BMIS account statement, *i.e.*, the Last Account Statement Method, to determine a claimant's net equity. Ex. 70; Nazareth Interview Mem. at 3. The Last Account Statement Method defined net equity as the amount indicated on the face of the last account statement a BMIS customer received in November 2008. Ex. 70. Under this approach, a customer's claim would be the amount listed in his account at the time he received his last statement. Nazareth said that she and the other signatories sent the May 1 Letter because SIPC and the Trustee were taking a different position, and it was clear that the SIPC/Trustee view would prevail unless the SEC objected. Nazareth Interview Mem. at 3. Nazareth stated that she knew that OGC typically handled such issues for the SEC and that Becker "would have been in charge of advising the Commission of what its position should be on this very important issue." *Id.* at 4. After sending the May 1 Letter, Nazareth sent Becker an e-mail alerting him that he would be receiving a letter that her firm and others had signed. Ex. 74.

Nazareth told the OIG that she wanted Becker to be involved in the consideration of the May 1 Letter. Nazareth Interview Mem. at 4. Specifically, she stated that she thought it would be good for him to attend the meeting that her colleagues hoped to organize to discuss the May 1 Letter. *Id.* She said that, if it was possible for Mr. Becker to attend, she and her colleagues "wanted to schedule around his ability to be there because he ultimately would be the decision maker and [they] thought it was important that he hear the arguments directly." *Id.*

Dewey & LeBoeuf LLP filed a Notice of Appearance in the Madoff Liquidation on behalf of himself, Seth Farber (who signed the May 1 Letter), and Kelly Librera to represent Ellen G. Victor, in her capacity as holder of certain BMIS accounts. Ex. 73.

[23] The OIG investigation did not find any evidence that Nazareth received preferential treatment from the SEC. Indeed, the SEC ultimately rejected the Last Account Statement Method. *See* Section IV.E *infra*. Nazareth stated that she became involved in this matter because she was one of the technical experts at her firm on securities matters and knew how SIPC worked. Nazareth Interview Mem. at 4. When asked whether it would have been helpful for her to be out front on this issue since people at the SEC knew her, she stated: "No." *Id.* at 4. Although many people at the SEC knew Nazareth, it was her understanding that the law firms that signed the May 1 Letter were "one of many groups" that came in to meet with the Commission on this issue and that there was "nothing unusual about this." *Id.* at 4. Becker testified to the OIG that the fact of Nazareth's background did not have any impact on the decision to consider the Last Account Statement Method and had no bearing on what he did in this case. Becker Testimony Tr. at 62. *See, e.g.*, NYRO Assistant Regional Director Testimony Tr. at 66-67 (fact that Last Account Statement Method was submitted by Nazareth "had no impact on my view" and "didn't sway my opinion"); OGC Assistant General Counsel #1 Testimony Tr. at 39 ("Q. Did that provide any greater weight to the letter because it came from somebody who was known at the Commission? A. Not with me. It was always going to be what does the statute provide and what does the controlling authority provide."); Sr. TM Official Testimony Tr. at 47 (opinion not "affected at all by the fact that she was former director – a former commissioner who was making this argument").

At the time of the May 1 Letter, Nazareth was aware that Becker's mother's estate had held a Madoff account. Nazareth Interview Mem. at 2. She recalled discussing the account with Becker in February 2009 after the New York Post published a list of Madoff's victims, and Becker noted that his mother's name was on the list.[24] *Id.* Nazareth stated that she and Becker did not discuss clawbacks in technical terms, but that they spoke generally about the fact that the estate had been liquidated. *Id.* Nazareth stated that she and Becker both viewed it as "sort of implausible" that the trustee was going to try to reach back and take money from innocent people or even from estates of innocent people whose accounts had been liquidated years before. *Id.* at 3. She further stated that both she and Becker thought this thing was "such a mess," but that his issues were "long gone." *Id.* Becker did not recall this conversation with Nazareth or specifically how he learned of his mother's estate's account, although he generally believed that he learned of the account around February 2009. Becker Testimony Tr. at 22-23.

Around the time that Becker received the May 1 Letter, the SEC received submissions from other groups of investors in support of the Last Account Statement Method and held meetings with such groups. Ex. 75; Ex. 76; Sr. TM Official Testimony Tr. at 36-39. OGC Assistant General Counsel #1 testified that at the end of a meeting with attorneys from the Lax & Neville firm (which had also made a submission in support of the Last Account Statement Method, *see* Ex. 76), Becker stated "that we were doing everything we could to get investors as much relief as possible consistent with SIPA, but that it would, of course, have to be consistent with what SIPA allowed, and that we would certainly take into consideration the arguments that they were making." OGC Assistant General Counsel #1 Testimony Tr. at 62.

B. Becker and OGC Attempted to Craft An Approach Based on the Last Account Statement Method

After receiving the submissions supporting the Last Account Statement Method, Becker and OGC gave serious consideration to that method. Becker testified that the May 1 Letter was his "first indication" of this potential issue. Becker Testimony Tr. at 40. He stated that his initial reaction was to educate himself and then "to hear what these folks had to say," which "struck [him] as very interesting." *Id.* at 52. Becker explained that, as a general matter, his view was that he wanted the Commission to take the position that allowed the greatest recovery to investors consistent with the law, and the approach was "to meet with a variety of people and to push them very hard on their legal analysis." *Id.* at 53-54.

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[24] The first publication of the list of Madoff investors occurred in a February 4, 2009 court filing, and various media outlets, including the NY Post, published coverage of the list (including the list itself) shortly thereafter. *See* Bruce Golding, *Full List of Madoff Victims Released*, N.Y. Post, Feb. 4, 2009, *at* http://www.nypost.com/p/news/regional/item_G2xCNoQk5YwetHg0f1JoKO;jsessionid=7FFEC591FCFF2 2531EA30BCCFD0E6169. Accordingly, Becker's discussion with Nazareth would have occurred sometime after February 4, 2009 and, accordingly, most likely after Becker had agreed to return to the SEC as General Counsel, which was announced on February 6, 2009.

Shortly after receipt of the May 1 Letter, OGC Assistant General Counsel #1 asked SIPC to provide a written explanation of why the method proposed by SIPC and the Trustee to establish net equity claims was appropriate in this case and consistent with SIPA. Ex. 77. On May 14, 2009, Wang sent a letter to OGC Assistant General Counsel #1 providing that explanation and analysis, with copies to Becker and others. *Id.* After receiving SIPC's submission, OGC Assistant General Counsel #1 prepared a memorandum analyzing the two approaches under consideration (*i.e.*, the Money In/Money Out Method and the Last Account Statement Method) and concluded that the Money In/Money Out Method was more sound legally. Ex. 78; OGC Assistant General Counsel #1 Testimony Tr. at 50. At that time, Becker stated, "This is very persuasive. Assuming the assets available are dwarfed by the claims, I don't see the basis for favoring the customers who withdrew money over those who haven't." Ex. 79.

On May 19, 2009, Becker participated in a meeting with Nazareth and other signatories of the May 1 Letter, along with staff from OGC and TM. Becker Testimony Tr. at 54; OGC Assistant General Counsel #1 Testimony Tr. at 40; Macchiaroli Testimony Tr. at 48; Nazareth Interview Mem. at 5; *see also* Sr. TM Official Testimony Tr. at 45. Becker testified that he recalled this meeting, where he pushed on what he called a "ridiculous" approach seeking recovery of "totally fictitious profits." Becker Testimony Tr. at 54. After that meeting, Becker, along with SEC Solicitor Jacob Stillman, suggested a related approach: "that claims be settled based upon amounts on account forms (including purported profits) up to $500,000 SIPA coverage, with fund of customer property distributed accrding [sic] to amount invested less amount withdrawn." Ex. 80; OGC Assistant General Counsel #1 Testimony Tr. at 56. OGC Assistant General Counsel #1 ultimately drafted a memorandum that she forwarded to Becker and others setting forth this bifurcated approach in more detail, which she described as a "new approach based on our discussion last week after meeting with counsel for the customers." Ex 81. Thereafter, OGC Assistant General Counsel #1 drafted a letter to SIPC for Becker's signature, based on the premise that "a persuasive case can be made that, under the Second Circuit's *New Times* decision, net equity should be based upon the amounts shown on the account statements."[25] Ex. 83.

On June 2, 2009, personnel from the SEC and SIPC met in advance of a meeting scheduled with the Trustee for June 4, 2009 to explain OGC's current approach to the net equity issue. Ex. 84. In an e-mail regarding that meeting, OGC Assistant General Counsel #1 stated that certain issues needed to be discussed, including: "Clawbacks – Has the trustee developed guidelines on the types of distributions that will be subject to

[25] Although this letter was not sent, OGC Assistant General Counsel #1 testified that she would not have prepared something for Becker's signature that did not reflect what he believed. OGC Assistant General Counsel #1 Testimony Tr. at 64. Moreover, the approaches set forth in the letter are consistent with what the SEC presented to SIPC a few days later, as OGC Assistant General Counsel #1 described via e-mail to Wang. Ex. 82.

recovery as fraudulent transfers/preferences?"[26] *Id.* OGC Assistant General Counsel #1's e-mail also attached a memorandum summarizing the June 2, 2009 meeting with SIPC staff, which noted that Harbeck made clear his view that OGC's suggested bifurcated approach was prohibited by SIPA. *Id.*

TM also did not agree with the bifurcated approach that OGC advanced. After the June 2, 2009 meeting with SIPC, Gallagher asked Macchiaroli, Sr. TM Official, and others in TM what the plan was "for coordination with GC during [the June 4] meeting when we may not agree with their analysis. You can bet that Harbeck will ask us if we agree." Ex. 86. Macchiaroli responded, "He asked yesterday. We expressed no views. We said it was a matter for the Commission." *Id.* Macchiaroli told the OIG that at that time, TM did not agree with the OGC approach but did not say anything specific to SIPC about their disagreement. Macchiaroli Testimony Tr. at 61; *see also* Gallagher Interview Tr. at 40 ("we didn't want to show two sides to the sitting . . . agency.").

Macchiaroli testified that TM did not favor OGC's proposed bifurcated approach and "thought that the statute was written differently," and that in his opinion "this is a view that's different from the way we generally understood the way SIPC works." Macchiaroli Testimony Tr. at 58. Sr. TM Official testified that he "thought that [the bifurcated approach] was dismissed quickly because it was just not consistent with the statute at all," and he "never thought that was a credible argument." Sr. TM Official Testimony Tr. at 63. *See also* Gallagher Interview Tr. at 40.

Attendees of the June 4, 2009 meeting included Becker, OGC Assistant General Counsel #1, Sr. TM Official, Macchiaroli, Harbeck and Wang from SIPC, Trustee Picard and his counsel David Sheehan, and personnel from FTI Consulting, which was acting as a consultant to the Trustee. Ex. 87; *see also* Picard Testimony Tr. at 21; Harbeck Interview Tr. at 38. Wang described her recollection of Becker's position at the June 4, 2009 meeting:

> [Becker] was very persistent on the view that the last account statement should be the measure of what customers were owed, which meant that you would basically recognize and honor fictitious profits.
>
> And I remember that he was relying on New Times, the first New Times decision in 2004, and so were we, but we seemed to have a miscommunication or misunderstanding that he was relying on one part of the decision and we were relying on another part.

[26] It appears that clawbacks may have been discussed at one or both of these meetings. As noted above, OGC Assistant General Counsel #1's e-mail summary of the June 2, 2009 meeting referred to clawbacks. Moreover, about two weeks later, another attorney from OGC who attended the meeting noted to OGC Assistant General Counsel #1 that a follow-up e-mail from the Trustee's counsel did not "mention where he was on publically announcing limitations on avoidance actions." Ex. 85.

Wang Interview Tr. at 12. Picard recalled Becker stating, "[W]e have to come up with a creative and political solution."[27] Picard Interview Tr. at 22.

C. OGC Continued to Consider the Last Account Statement Method and Other Possible Methods During the Summer of 2009

After the meetings with SIPC and later in June 2009, there was concern that certain court deadlines could make it necessary for the Commission to commit to a position on an expedited basis. OGC Assistant General Counsel #1 Testimony Tr. at 73-74; Ex. 88. However, the court ultimately set a schedule that required briefs to be filed later in the year. OGC Assistant General Counsel #1 Testimony Tr. at 74. On June 24, 2009, OGC Assistant General Counsel #1 circulated to Becker and others a draft Action Memorandum recommending the position the Commission should take in the Madoff Liquidation on the appropriate determination of net equity. Ex. 89. The draft memorandum identified the novel question of law as whether SIPA permits a customer to receive a claim for net equity "based upon an account statement showing fictitious transactions in real securities at prices that are consistent with reported prices of the real securities and reflecting fictitious earnings that are consistent with reported earnings on those securities." *Id.* It also set forth two alternatives as described in the draft June 1, 2009 letter to SIPC. *Id.* at 17-22.

The draft memorandum acknowledged that OGC was aware of SIPC's and the Trustee's concern about the interplay between the Last Account Statement Method and clawbacks:

> SIPC and the Trustee are concerned that the bankruptcy court will find it inconsistent to allow the Trustee to bring avoidance actions to recover fraudulent transfers of fictitious profits and at the same time pay customer claims based on fictitious profits (as would happen under the final account statement method). If the court were to limit the trustee's ability to bring avoidance actions, SIPC believes that the estimated $6 billion in recoveries could be reduced to an estimated $1.8 billion. While this is certainly a matter of concern, we are not convinced that this would happen. SIPC and the Trustee do not point to any provision in the Bankruptcy Code that would prevent a court from allowing both claims for fictitious profits and recovery of avoidable transfers based on fictitious profits. Assuming the

[27] Also at the June 4, 2009 meeting, Harbeck told Gallagher: "This is the meeting you said I would never have to go to." Harbeck Interview Tr. at 41; Gallagher Interview Tr. at 41. Harbeck was concerned that, like in the *New Times* case, the Commission initially had adopted a position and was now moving away from that position, and Gallagher was also concerned about that issue. Gallagher Interview Tr. at 41-42.

> requirements for avoiding a preferential or fraudulent transfer were met, it is unclear what the bankruptcy court's basis would be for denying a trustee's action to recover such transfers.

Id. at 17.

Around this same timeframe, on June 25, 2009, Chairman Schapiro met with SIPC Chairman Armando Bucelo and Harbeck, and Becker recalled attending that meeting. Schapiro Testimony Tr. at 45-46; Sr. TM Official Testimony Tr. at 73; Harbeck Testimony Tr. at 40; Becker Testimony Tr. at 55. In preparation for that meeting, TM prepared an agenda setting forth the various issues that were likely to be discussed. Ex. 90; Sr. TM Official Testimony Tr. at 69. The agenda was drafted from SIPC's viewpoint and provided talking points for TM's response. For example, the agenda stated:

> Claims have been processed using a methodology, and a calculation of claims values, that was thoroughly reviewed by and extensively discussed with Commission staff. At our February 19, 2009, meeting, SIPC was informed that each Commissioner had been briefed on this issue as well. Now, months into the process and after committing $170 million of the SIPC Fund based upon an agreed upon method, SIPC understands that some staff members of the Commission may seek to have SIPC and the Trustee change that methodology and calculation of claims values. Although the proposed change has never been fully explained, the proposed change as SIPC understands it is contrary to the SIPA statute . . . .
>
> TM Staff Response
>
> - The staff is exploring alternative methodologies for resolving customer claims that their "net equity" under SIPA should be based on the value of their last account statement rather than the "money-in/money-out" method being used by the trustee.
> - The staff is exploring whether a resolution with SIPC and the trustee could be reached where Madoff's "retail" customers would receive a payment from the SIPC Fund but not share in the pro rata distribution of the pool of customer property unless they had a claim under the money-in/money-out methodology.

Ex. 90 at 2-3. To prepare for the meeting with SIPC, Chairman Schapiro met with Gallagher, Sr. TM Official, and Becker, along with one of her counsel, on June 24, 2009. Schapiro Testimony Tr. at 39; Sr. TM Official Testimony Tr. at 69-70; Ex. 91.[28] Chairman Schapiro's notes of the meeting state: "clawback is not possible with the broader distribution approach." Ex. 92; Schapiro Testimony Tr. at 40. The Chairman testified under the Last Account Statement Method, "there would be less likelihood, maybe no likelihood of clawbacks being possible."[29] *Id.*

Regarding the meeting with SIPC, Chairman Schapiro recalled "frustration [by] SIPC that we had not nailed down ultimately and definitively where we were going to go, that the Commission was continuing to look at the issues and explore the different options and understand what the . . . pros and cons were of final account statement versus cash-in/cash-out." Schapiro Testimony Tr. at 47. Sr. TM Official described the meeting in a contemporaneous e-mail:

> We spent most of the hour discussing Madoff. SIPC's position is that money in/out is consistent with the law and SEC liquidations, and that other methods would hurt customers who are net losers. SIPC believes it is important that claims based on theories other than money in/out be denied, the SEC support that position in court, then SIPC would offer a settlement to customers based on terms agreed to with the SEC.
>
> Becker offered support for money in/out, but wanted the trustee to offer payments first and settle claims as part of the claims determination. The difference with SIPC is that OGC wants settlements first, bankruptcy litigation later.

Ex. 93. Sr. TM Official also stated in his e-mail that OGC had asked TM to co-sign a memorandum seeking an order to exempt customers from the then-pending claims bar date. *Id.* Gallagher responded to see if TM could avoid joining, but said, "if we have to I am okay with it. I would rather join GC on this issue and then continue to disagree on money in money out." *Id.* Gallagher explained to the OIG that he recalled that TM was still in favor of the Money In/Money Out Method proposed by SIPC and the Trustee. Gallagher Interview Tr. at 44.

On July 15, 2009, OGC Assistant General Counsel #1 and NYRO Assistant Regional Director discussed which net equity approach Becker would prefer. Ex. 94.

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[28] Gallagher did not recall attending that meeting. Gallagher Interview Tr. at 43.

[29] Chairman Schapiro testified that at the time of this meeting, she thought of clawbacks in terms of the very large suits that the Trustee was bringing against feeder funds and large hedge funds, and that she did not connect clawbacks in any way to Becker and his mother's estate's BMIS account. Schapiro Testimony Tr. at 40-41.

NYRO Assistant Regional Director asked OGC Assistant General Counsel #1 whether she thought "David is still leaning toward Lax's position," referring to the Lax Neville law firm which advocated the Last Account Statement Method. *Id.* OGC Assistant General Counsel #1 responded that she did not think so, stating: "Actually, what he wanted was some way to allow distribution from SIPC fund to be based on account statement, while distributions from fund of customer property would be money in/money out. We're still looking at this, but I'm not optimistic there's a way to do it that doesn't entail substantial risk that court would say otherwise." *Id.* NYRO Assistant Regional Director responded that she was "[g]lad he is looking at the hybrid approach . . . ." *Id.*

D. Throughout This Entire Time, the Trustee Continued to Administer the Madoff Liquidation Both by Paying Claims and Bringing Clawback Suits

As discussed earlier, SIPC and the Trustee wanted to move quickly to begin processing claims. *See* Section II.A *supra*. By July 2, 2009, the Trustee had received at least 15,400 customer claims, over 395 claims from general creditors, and 16 claims from broker dealers. Trustee's First Interim Report for the Period December 11, 2008 through June 30, 2009, Bankr. S.D.N.Y. Adv. Pro. No. 08-1789 (BRL), at 20 n.9 (dated July 9, 2009), http://www.madofftrustee.com/TrusteeReports.aspx. By June 30, 2009, the Trustee had determined and allowed 543 claims and committed to pay $231,017,981 in cash advances made by SIPC, which was, at that time, already the largest commitment of SIPC funds in the history of SIPA liquidations. *Id.* ¶ 71. By October 31, 2009, the Trustee had determined 2,870 claims, allowing 1,561 claims and committing to pay approximately $535 million in cash advances made by SIPC. Trustee's Second Interim Report for the Period July 1, 2009 through October 31, 2009, Bankr. S.D.N.Y. Adv. Pro. No. 08-1789 (BRL), ¶¶ 91-92, http://www.madofftrustee.com/TrusteeReports.aspx. In his interview with the OIG, the Trustee stated that the SEC's position (which was not agreed upon until November 2009 and differed from the approach taken by SIPC and the Trustee) has not yet altered how he administers the Madoff Liquidation, but that, "in the event that ultimately a court would decide we're doing it wrong, we'd go back to square one, and then revisit the claims." Picard Interview Tr. at 29. He further explained that revisiting the claims would "[a]bsolutely" involve a substantial amount of work, as well as a lot of money. *Id.*

Moreover, from the outset of the Madoff Liquidation, there was widespread press coverage regarding the possibility of clawback suits by the Trustee. As early as December 19, 2008, the N.Y. Times reported that "even Mr. Madoff's most fortunate clients may wind up having to give back some of their gains, as investors might have to do in another recent financial fraud, the collapse of the hedge fund Bayou Group in 2005" and quoted an industry lawyer as stating, "Such so-called clawbacks may occur even if the client had no idea that the gains were fraudulent." Alex Berenson, *Even Winners May Lose Out With Madoff*, N.Y. Times, Dec. 19, 2008, at A1. Indeed, one N.Y. Post article noted that "[l]imiting the number of claw-back cases will limit the eventual victim

payouts."[30] James Doran, N.Y. Post, *Claw & Disorder – Victims: Madoff Trustee Not Looking Out for Us*, May 3, 2009, at 31. The Trustee discussed the clawback actions brought to date in the interim reports it filed with the court during this timeframe. *See* First Interim Report ¶¶ 115-25; Second Interim Report ¶¶ 178-216.

Despite knowing that SIPC and the Trustee wanted to act quickly and had begun processing customer claims, the SEC did not determine its position until it had to do so pursuant to the court's scheduling order. OGC Assistant General Counsel #1 testified:

> Well, the timing was going to be determined by when the Commission had to file a brief on the matter. And so [SIPC] could say this [statement in May 14, 2009 letter that they be advised immediately if the Commission intends to express a different view], but realistically, . . . we would be working on it and . . . we don't know when the Commission is going to express a contrary view until we've really looked at it. So at this point, I just sort of thought, well, okay. That's fair enough for them to ask. I'm not sure whether we'll be able to do it.

OGC Assistant General Counsel #1 Testimony Tr. at 53-54. Because any briefing would not be due to the bankruptcy court until November 2009, the internal urgency lessened, and OGC continued to consider the net equity issue. Becker testified that he "didn't care" about whether SIPC was unhappy with the SEC's approach to the appropriate method of calculating net equity because "[w]e're supposed to do the right thing. . . . whether SIPC likes it or not." Becker Testimony Tr. at 57.

In addition, Becker discounted SIPC's perspective that it was important to consider the effect of the net equity approach on the SIPC Fund. For example, in a May 28, 2009 e-mail, NYRO Assistant Regional Director referred to Harbeck's general "desire to 'protect the fund.'" Ex. 95. *See also* NYRO Assistant Regional Director Testimony Tr. at 70-72. The Chairman's notes of her preparation for a June 25, 2009

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[30] *See also* James Bernstein, *Madoff Victims On The Hook?*, Newsday, Jan. 16, 2009, at A37 ("If you invested money with accused swindler Bernard Madoff, and then in the past few years made withdrawals, you could, according to federal law, be required to give that money back in what is known as a 'claw back.'"); Dareh Gregorian, *Madoff Didn't Invest One Dollar for 13 Years*, N.Y. Post, Feb. 21, 2009, at 11 (Trustee's counsel "warned that some innocent investors who thought they'd just made out well with Madoff could also take a hit. Sheehan said administrators from a recovery fund would try to recover 'false profits' that had been 'earned' by some investors."); Walter Hamilton, *Madoff clients air grievances*, L.A. Times, Feb. 21, 2009, at Business 1 ("But Picard and his partner, David Sheehan, also warned that in some cases they would seek to 'claw back' money from investors who over the years received more cash from Madoff than they actually deposited with him."); Kevin McCoy, *Madoff clients' lawsuits look to others for recompense*, USA Today, March 3, 2009 ("In a legal procedure known as a claw-back, Picard can attempt to force some of those investors to return the funds. Federal or state laws authorize him to target any 'preference' repayments made within 90 days of the December collapse of the alleged fraud, plus so-called fraudulent transfers stretching back as long as six years.").

SIPC meeting where the net equity issue was addressed referred to SIPC concerns about "drain[ing] the fund," "necessitat[ing] SEC going to Congress," and "dramatic fee increases for broker-dealers." Ex. 92; Schapiro Testimony Tr. at 38-39. Chairman Schapiro testified that she thought that her notes indicated that the SEC was "very concerned that [SIPC] will say that if we go with a final account statement view of what [its] obligations are, that it will deplete the SIPC funds."[31] Schapiro Testimony Tr. at 39.

When asked how he factored the amount of money in the SIPC Fund into consideration, Becker testified:

> I can't say that I did very much. . . . [T]his is a legal question, what does the law provide. And that is a separate question from whether there is money to pay for it. I do believe that if the Court of Appeals for the 2nd Circuit says this is the right result, that SIPC would not ultimately say, "Well, we're not going to assess our members to pay for it."

Becker Testimony Tr. at 58. He further stated, "The fund is a little bit of a red herring. I mean, the fund, and there is a backup treasury line of credit, it might take some time to go through that and to assess the members, but it's essentially, the issue is a cash flow issue, not an availability of funds because the funds come from the brokerage industry." *Id.* at 59. *See also* Ex. 96 ("In that regard [of adhering to *New Times* but avoiding giving investors profits of fraudulent scheme], I'd be powerfully influenced by the numbers. . . . I'm less concerned about the impact on the SIPC fund, unless it's really ruinous.").

Similarly, OGC Assistant General Counsel #1 testified that she recalled conversations about the impact on the SIPC Fund, stating:

> We basically were going to look at it from the point of view of what does SIPA allow and what is consistent with the New Times decision and get the best outcome for the investors. And that if that is the way the claim, the net equity claim should be determined, then if the SIPA fund runs out of money, then there is a mechanism. . . . So . . . we weren't really looking at it from that point of view.

OGC Assistant General Counsel #1 Testimony Tr. at 86-87. She also stated that she wanted to understand the views of SIPC or TM to the extent they had a different

[31] The Chairman's notes also indicated, "This is a SIPC survival issue." Ex. 92; Schapiro Testimony Tr. at 43. She testified that she did not know who made this comment, but that "it may be that somebody said that's how SIPC views this, as a survival issue . . . because the fund would be depleted, and it would set a precedent that would be very hard for them to meet over time given the fact that these liquidations had become so huge." Schapiro Testimony Tr. at 43.

perspective on the issue, "[b]ut whatever SIPA allowed under the circumstance was where we would make the recommendation." *Id.* at 87.

E. Becker and OGC Formulated the New T-Bill Approach

OGC ultimately determined that the Last Account Statement Method or any variation thereof was not consistent with SIPA. Becker testified that he could not reconcile the Last Account Statement Method with the law, stating: "Legally, it's not legitimate to say that we believe we have entitlement to assets that have never existed and that are just a figment of someone's imagination." Becker Testimony Tr. at 60. OGC Assistant General Counsel #1 also testified that after the court ordered a briefing schedule, she had the opportunity to "look at everything again" and felt that with the Last Account Statement Method, "there were fraudulent profits that could not be attained in real market trading and that the court would not allow a claim based on that." OGC Assistant General Counsel #1 Testimony Tr. at 80. Because the Last Account Statement Method, or other variations based upon that method, were not viable, OGC Assistant General Counsel #1 thought that the Money In/Money Out Method would be the only remaining option, but continued to consider whether there was "any other possibility that [she had not] looked at."[32] *Id.*

While looking at Madoff account statements, OGC Assistant General Counsel #1 came up with what she described as a new and different approach to the net equity issue. OGC Assistant General Counsel #1 Testimony Tr. at 80-83; Ex. 97. This approach was generally described as the T-Bill Approach.[33] Under this approach, "[c]ustomers get the principal amounts they deposited less amounts they took out, but as long as there's principal in the account, it earns the amount it would have earned if the cash had been swept into the Fidelity U.S. Treasury Money Market Fund." *Id.* Immediately after OGC Assistant General Counsel #1 proposed this approach, Becker was in favor of it, stating: "Wow. This sounds right." Ex. 97; OGC Assistant General Counsel #1 Testimony Tr. at 84. OGC Assistant General Counsel #1 then e-mailed TM about the new approach, stating: "I discussed this with David [Becker] this morning and he thinks it works. Do you?" Ex. 98.

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[32] *See also* Conley Testimony Tr. at 16-17 ("And my understanding was that at that point [OGC Assistant General Counsel #1] had basically reached the conclusion that the final account statement approach wasn't supportable under the statute and the case law and that as between the two, net investment or money-in/money-out, was more supportable by the case law. . . . However, she was looking at possible ways of whether there was any flexibility in terms of how one would apply the net investment or money-in/money-out approach.").

[33] Several later e-mails refer to a partial or full T-Bill Approach. This distinction was used (generally by personnel within Risk Fin) to indicate the difference between the approach where one would apply a T-Bill rate only when the BMIS account statements indicated that the money was out of the market, *i.e.*, the partial T-Bill approach, and the approach where one would apply a T-Bill rate throughout the time of a customer's investment with BMIS, *i.e.*, a full T-Bill approach. *See, e.g.*, Hu Testimony Tr. at 13-15.

TM did not support this new T-Bill approach. In an e-mail forwarding OGC Assistant General Counsel #1's initial analysis of the new method, Macchiaroli said that this is "as goofy as [N]ew [T]imes" and subsequently noted, that "Eureka [which was the subject line OGC Assistant General Counsel #1 used in her e-mail describing the new approach] is the wrong word. It should be ugh." Ex. 98. TM did not think that this approach was consistent with SIPA. Macchiaroli Testimony Tr. at 74; Gallagher Interview Tr. at 47-48; Sr. TM Official Testimony Tr. at 77-78.

A few weeks later, OGC Assistant General Counsel #1 prepared a draft Action Memorandum to the Commission based on the T-Bill Approach. Ex. 99. Becker remained in favor of the approach, stating twice that the draft was "really, really impressive." Ex. 96. In response to Becker's comments, NYRO Assistant Regional Director weighed in, suggesting reaching the same conclusions "without emphasizing the lack of legitimacy of the investor's expectations" and also noting her concern with "the vast number of current customers who will get nothing and possibly face fraudulent conveyance actions." *Id.* Notably, at this time, the draft reflected that OGC did not know whether TM would concur in its recommendation. Ex. 99 at 2; *see also* Sr. TM Official Testimony Tr. at 80 ("there was a lot of discussion whether we should concur with it or not. . . . So my recollection is that we thought we couldn't support that approach."); Gallagher Interview Tr. at 49 ("I think my recollection . . . was whether the division would dissent. . . . There was never a question as to whether we would concur.").

The SEC presented this T-Bill approach to the Trustee in a September 30, 2009 letter from Becker to Picard, which also referred to a September 25, 2009 meeting between the SEC, the Trustee, and his counsel regarding the same topic. Ex. 100. In her cover e-mail to the Trustee, OGC Assistant General Counsel #1 noted that OGC had changed its approach slightly from what was discussed at the September 25 meeting at Becker's request, stating, "After further discussion with David [Becker], he decided to request that the proposal be limited to times the BLMIS account statements showed that customer assets were out of the market and invested in short-term U.S. Treasury securities." *Id.*; *see also* OGC Assistant General Counsel #1 Testimony Tr. at 88. Becker's letter to the Trustee provided further explanation of the revised approach and requested that the Trustee perform certain analyses to provide an "understanding of the effect of such an alternative on customer net equity claims. . . ." Ex. 100.

F. Becker and OGC Decided on the Constant Dollar Approach

While considering the T-Bill Approach, OGC asked Risk Fin to assist in its determination of the appropriate net equity calculation by performing certain analyses. Risk Fin Senior Official #1 Testimony Tr. at 13; OGC Assistant General Counsel #1 Testimony Tr. at 91-92. An October 9, 2009 e-mail describes a meeting between Risk Fin Senior Official #2 and OGC Assistant General Counsel #1, Conley, and others in OGC in which Risk Fin Senior Official #2 had suggested the alternative of a risk-free rate of return. Ex. 101. Risk Fin Senior Official #2's e-mail also stated: "Conley seemed to

think that Becker might buy this argument." *Id.* OGC Assistant General Counsel #1 testified that the day after the initial meeting between OGC and Risk Fin personnel:

> I went up to David Becker's office early in the morning and said, "We had the meeting and they're suggesting constant dollars."
>
> **And David immediately thought that was an excellent way to resolve the situation and the difficulties**. . . .
>
> Q. But David Becker very much agreed with the constant dollar approach[?]
>
> A. Yes. He thought that to the extent that that resulted in customers who had already -- older customers getting more, then that was reflecting the erosion of value in the dollar so that it was really equalizing the returns.
>
> * * *
>
> [A]fter we had the meeting with the [Risk Fin] people and they suggested constant dollars[,] . . . I reported that back to David and he said, "I think that's the best way to go."

OGC Assistant General Counsel #1 Testimony Tr. at 94-95, 96 (emphasis added).[34] This method became known as the Constant Dollar Approach, and it contemplated applying some sort of inflation rate, such as the Consumer Price Index ("CPI"), to determine a customer's net equity. OGC Assistant General Counsel #1 Testimony Tr. at 93; Conley Testimony Tr. at 26-27, 34; Becker Testimony Tr. at 60-62.

After an additional meeting that occurred on or about October 13, 2009, Risk Fin drafted a memorandum proposing what it considered to be a fourth approach, which was a variation on the T-Bill Approach. Risk Fin Senior Official #1 Testimony Tr. at 28-30; *see also* Ex. 102. Shortly thereafter, then-Risk Fin Director Henry Hu sent an e-mail to OGC explaining why Risk Fin did not support OGC's T-Bill Approach, as compared to the Full T-Bill Approach, which Risk Fin was proposing. Ex. 103. In response to this e-mail, Becker stated:

> I think we are in full agreement [ ]. It's not clear that the SIPA permits calculation of net equity taking interest into account, so we would argue that when one is (a) either

[34] OGC Assistant General Counsel #1's testimony is consistent with her statements at the Commission meeting on November 9, 2009 regarding the development of the Constant Dollar Approach. *See* Section IV.H *infra*.

> calculating the value of equity by subtracting money withdrawn from money invested or (b) allocating the residual estate among victims of a twenty-year scheme, it makes sense to do so on a constant dollar basis. That way, one doesn't value based on a fiction, but one doesn't ignore the time value of money either.

Id. Shortly after Becker sent his e-mail, Conley responded to Becker, copying OGC Assistant General Counsel #1, stating: "[OGC Assistant General Counsel #1] did mention our revised 'constant dollar' approach to [Risk Fin Senior Official # 1] yesterday, but that apparently did not make it to Henry before he sent this."[35] *Id. See also* Conley Tr. at 25-27 (explaining that Becker was hesitant to use the T-Bill Approach because it still seemed to validate at least some part of Madoff's fraud, and that OGC then considered the alternative of taking just inflation into account, *i.e.*, the Constant Dollar Approach.

Becker advocated using the Constant Dollar Approach in his communications with OGC staff. For example, on October 17, 2009, OGC Assistant General Counsel #1 sent an e-mail to Becker and Conley regarding "scrapping" the T-Bill Approach. Ex. 104. Her e-mail stated that she no longer thought the approach was useful and that the choice would be between the Money In/Money Out Method, the method proposed by Risk Fin, and the Constant Dollar Approach. *Id.* In response, Becker e-mailed: "Seems to me the clear winner is cash in, cash out expressed in constant dollars."[36] *Id.* Conley testified that in this e-mail, Becker was referring to the Constant Dollar Approach and that this was the point where OGC had determined to go with that approach exclusively. Conley Testimony Tr. at 27-28. Additionally, on October 26, 2009, Becker e-mailed OGC Assistant General Counsel #1 and Conley, stating: "Henry [Hu] is fine with taking out references to risk-free rate of return." Ex. 106. After Conley replied to that e-mail and referenced his intention to discuss the issue with TM, Becker responded: "If we all agree, we can make clear that we are recommending constant dollars, subject to further information from the Trustee."[37] *Id.*

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[35] Becker's statement regarding "full agreement" appeared to be at odds with Hu's proposal because, by this point, OGC was considering the Constant Dollar Approach, while Hu was advocating the full T-Bill Approach. OGC Assistant General Counsel #1 explained that Hu's reference to the full T-Bill Approach based on the time value of money was "kind of a misstatement because the time value of money is going to be the [CPI] [while] the T-Bill method is the economic value of . . . opportunity costs," and it appeared that Hu had not been advised of the Constant Dollar Approach at the time of his e-mail. OGC Assistant General Counsel #1 Testimony Tr. at 96; *see also* Conley Testimony Tr. at 24.

[36] Similarly, on October 19, 2009, Becker e-mailed Hu that "the constant dollar idea is best presented, not as a means to compensate some investors, but rather, as your comments note, as a means of applying the cash in/cash out rule in an economically consistent manner." Ex. 105. He also stated in a separate e-mail to Hu that same day that the Constant Dollar Approach is "just a tweak to cash in/cash in [*sic*] (although one with some significant financial consequences)." *Id.*

[37] Conley testified that until the time of this e-mail, Risk Fin had continued to support its alternative approach, but the "conclusion that was made was, no, all we want to do here is just attempt to equalize the

Becker testified that he personally felt that the Constant Dollar Approach was best legally, as in the circumstances of a long-running Ponzi scheme, "using constant dollars struck us, struck the Commission, as a better surrogate for securities . . . than simply money in/money out . . . ." Becker Testimony Tr. at 60-61. He explained why it was determined to go with an inflation rate, as opposed to a T-Bill rate, stating: "[M]y view was -- T-Bills were about risk free returns, and inflation is about valuing money in terms of its purchasing power. And my view was this is not to give people a return. It's not going to give them interest on their money, but rather, particularly for intergenerational terms, is to use a constant measurement of what that cash in is actually worth." *Id.* at 61-62. At the time of the Commission meeting to consider the staff's recommendation, Becker drafted a document explaining why the Constant Dollar Approach was appropriate, which concluded, "All we are doing by using constant dollars is approximating the value in today's dollars of a hypothetical security that had been purchased for the amount invested and then held in the BMIS account until the filing date." Ex. 107.

Accordingly, Becker ultimately decided that the Constant Dollar Approach was the right approach to recommend to the Commission.[38]

G. Becker Recommended the Constant Dollar Approach to the Commission

On October 28, 2009, OGC circulated an Advice Memorandum to the Commission which was signed by Becker. Ex. 108. Becker acknowledged that he signed the Advice Memorandum, had "extensive involvement" with it, and believed it was correct. Becker Testimony Tr. at 63. The memorandum proposed that, unless the Commission chose otherwise, the staff would not file a brief in support of the Last Account Statement Method in the BMIS liquidation proceeding, but instead the Commission's brief should support the Trustee's Money In/Money Out Method. Ex. 108 at 1. The memorandum also noted "that it may be appropriate to calculate cash-in/cash-out in a manner that accounts for the 'time value' of funds invested in Madoff's scheme (the 'time-equivalent-dollar' method)," and stated that it would submit a supplemental memorandum on that issue. *Id.*

The Advice Memorandum indicated that TM "concurs in the proposal that the Commission file a brief taking the position that net equity should be calculated using a

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investors from the perspective of the passage of time and inflation or deflation that occurred over that time." Conley Testimony Tr. at 34.

[38] Even after the recommendation was made to the Commission, OGC Assistant General Counsel #1 continued to believe that the T-Bill Approach was appropriate. OGC Assistant General Counsel #1 Testimony Tr. at 95, 98-99. Hu continued to believe that his full T-Bill Approach, using a risk-free rate of return as opposed to an inflation adjustment, was appropriate, although he understood that there were some constraints imposed under SIPA that had to be taken into account when determining the recommendation. Hu Testimony Tr. at 20-21.

cash-in/cash-out method," but "does not necessarily concur with the view that SIPA would permit the calculation of net equity on a time-equivalent-dollar basis." *Id.* at 2. TM personnel testified that they did not support OGC's position on the Constant Dollar Approach to the Money In/Money Out Method. For example, Sr. TM Official testified, "My view has not changed about how the statute should be interpreted, but the Commission makes -- is the one ultimately charged with that responsibility. So I respectfully disagree with their approach . . . ." Sr. TM Official Testimony Tr. at 96-97. *See also* Macchiaroli Testimony Tr. at 77 (he personally did not support OGC's position on this issue).

The Advice Memorandum expressly addressed the impact on clawback actions of using a time-equivalent dollar value of money:

> Calculating customers' claims based on the time-equivalent dollar value of the money that customers invested in and withdrew from their BMIS accounts could have an impact on the Trustee's avoidance actions [*i.e.*, clawback actions] seeking to recover, as preferences or fraudulent transfers, payments made to customers prior to the firm's failure. Thus, a customer might have a claim for net equity consisting of amounts exceeding principal under the time-equivalent-value method of calculating cash-in/cash-out, while also being subject to an avoidance action by the Trustee to recover amounts exceeding principal that were withdrawn before BMIS failed. There is no easy answer to this anomaly. The SIPA requirement that a customer receive the net equity in his or her account, however, would take precedence over any potential effect on avoidance actions [*i.e.*, clawback actions] to recover assets for the fund of customer property.

Ex. 108 at 26.[39] The Advice Memorandum also stated the OGC belief that "calculating net equity [using time-equivalent dollars] is not precluded by SIPA, existing case law, or past Commission positions" and that "this case raises issues that neither courts nor the Commission have confronted previously." *Id.* at 5. The Advice Memorandum discussed the Commission's brief in the *New Times* case and noted that the Commission's position then was that net equity was the amount that the customer paid to purchase the securities. *Id.* at 15-16. It also discussed a law review article on claims allowance in Ponzi schemes and concluded that the weight of authority favors a principle akin to the Money In/Money

[39] Becker testified that he recalled this paragraph of the memorandum, but did not recall discussions about clawbacks generally. Becker Testimony Tr. at 63-64. He testified that, to his recollection, any discussion of clawbacks was limited to the circumstances described in this paragraph, *i.e.*, clawback actions for customers who had an open account at the time of the Madoff Liquidation, and had nothing to do with clawback actions like the one in which he is a defendant. *Id.* at 64.

Out Method. *Id.* at 16-17. It further noted that there are "surprisingly few cases" involving the allowance of claims by investors in Ponzi schemes. *Id.* at 16.

H. OGC, Under Becker's Direction, Led the Discussion at the Commission Meeting to Consider the Appropriate Net Equity Determination

On November 9, 2009 at 10:04 a.m., the Commission met in Executive Session to consider the Advice Memorandum, which was continued to November 10, 2009 at 10:04 a.m. and 3:23 p.m. Ex. 109. At this point, the Commissioners, other than Chairman Schapiro, were not aware of Becker's interest in his mother's estate's BMIS account. *See* Section III.B *supra*. Becker participated in the entire session, along with OGC Assistant General Counsel #1 and Conley from OGC.[40] *Id.* The minutes and transcript indicate that OGC led the discussion and presentation, with TM and Risk Fin providing limited comments.

OGC Assistant General Counsel #1 provided OGC's initial presentation to the Commission. She gave an overview of the process that OGC had gone through to arrive at its recommendation. OGC Assistant General Counsel #1 told the Commission that Harbeck had met with the staff in January in an attempt to reach agreement about how to handle claims based on the Money In/Money Out Method. Ex. 109 at 2. She then stated that during the spring, the staff met with counsel for some investors who objected to the Money In/Money Out Method and proposed the Last Account Statement Method. *Id.* OGC Assistant General Counsel #1 noted that "some of the counsel represented wealthy clients and others represented clients suffering severe hardship because they had lost everything they had to live on." *Id.* at 2-3; *see also* Ex. 110 at 5. She stated: "At the conclusion of one meeting, I remember David Becker telling counsel that we would do whatever we could to find a way to help the customers that the law would allow." Ex. 110 at 5; *see also* Ex. 109 at 3.

OGC Assistant General Counsel #1 further explained to the Commission that OGC's initial reaction was that SIPC and the Trustee's view made sense, but that the staff's second reaction was that the Second Circuit could rule that the account statements should govern. Ex. 109 at 3; *see also* Ex. 110 at 5-6. She then stated that information that the staff had from the Trustee showed that under the Money In/Money Out Method, "over half of the customers had withdrawn more than they put in and would receive no payments under the cash in cash out method." Ex. 109 at 3; *see* also Ex. 110 at 6. She added that "the staff thought this was an unacceptable result and should be avoided if possible under the statute," and noted, "[O]nly if the statute forced us there, did we want to be there." Ex. 109 at 3.

[40] The minutes indicate that Cahn and Stillman of OGC also attended the meetings, but neither the minutes nor the transcript indicate that either played a substantive role in the discussions.

OGC Assistant General Counsel #1 next described the staff's efforts to develop a bifurcated approach to the claims, but concluded that such an approach did not work under the applicable law. Ex. 109 at 3; *see also* Ex. 110 at 6-7. She stated that in analyzing the *New Times* decision, the staff determined that the Second Circuit was not likely to allow the account statements based on fraudulent transactions to form the basis of a claim and then "backed into the position that cash in, cash out was the alternative." *Id.* at 3-4; *see also* Ex. 110 at 8.

OGC Assistant General Counsel #1 then described the T-Bill Approach that OGC had considered and stated that its advantage was "that it would result in more investors having claims and the investors with claims getting a greater return." Ex. 109 at 4; *see also* Ex. 110 at 9-10. OGC Assistant General Counsel #1 explained that at this point, OGC brought Risk Fin into the discussion to assist them in working with the Trustee to analyze the effects of the T-Bill Approach. Ex.109 at 4, *see also* Ex. 110 at 10. She stated that Risk Fin suggested another approach that would give effect to inflation and missed investment opportunity. Ex. 109 at 4; Ex. 110 at 10.

Both the transcript and minutes of the meeting demonstrate that OGC Assistant General Counsel #1 informed the Commission that it was Becker who made the ultimate decision to pursue the Constant Dollar Approach. According to the transcript, during the meeting, OGC Assistant General Counsel #1 stated:

> That's when we went to talk to David [Becker]. This was Mike Conley and I. We said this is what Risk Fin was suggesting. David [Becker] said oh, well, the best thing to do is approach this as constant dollars. Who could object to satisfying this claim based on constant dollars. That isn't interest.
>
> That basically became the approach that we came up with, and that's the approach that's generally sketched out in the October 28 memo that we sent to you.

Ex. 110 at 10-11. Similarly, the minutes stated: "OGC Assistant General Counsel #1 said that when they discussed this suggestion with David Becker, he said the best thing to do would be to approach this as constant dollars, and that is the approach the GC staff sketched out in an October 28 memo to the Commission."[41] Ex. 109 at 4.

[41] When Commissioner Casey noted the need to have a full understanding of the implications of the approach, Conley responded: "We did think about that, Commissioner. Essentially, we reached the conclusion that David [Becker] did, which is it is certainly a reasonable thing to think about in another context." Ex. 110 at 23-24.

[redacted] During that discussion, Becker stated:

> It's an entirely circular word that means legitimate is what we recognize. We are in [a] universe where of course it is reasonable for people to expect not to be defrauded. Of course, it's reasonable for people to rely on what looked like highly professional and impressive account statements. While the Trustee does take a [pot shot] at people, how could they expect to get this – I'm not terribly persuaded by that.

FOIA Exemption 5

Ex. 110 at 32; *see also* Ex. 109 at 8.

At the conclusion of the November 9 portion of the meeting, the Commission and the staff discussed next steps. [redacted] It was decided that OGC would circulate a supplemental memorandum regarding the Constant Dollar Approach in order to allow the Commission to determine what its approach would be.[42] Conley circulated the supplemental memorandum, which provided additional information on the Constant Dollar Approach, later that day. Ex. 112.

FOIA Exemption 5

When the meeting reconvened on the following day, OGC Assistant General Counsel #1 provided an overview of why calculating net equity in constant dollars was not inconsistent with SIPA and why OGC believed it was not possible to file a brief taking the position that net equity should be based on the Last Account Statement Method. Ex. 109 at 10-13. Conley then addressed how the Constant Dollar Approach would apply in other SIPC liquidations and in non-SIPC situations. *Id.* at 14. [redacted] Becker responded that the OGC approach "certainly assumes that all the claimants are equally culpable or non-culpable" and noted that there are remedies available to the Trustee if there is evidence to the contrary. Ex. 110 at 23; Ex. 109 at 15. This portion of the meeting also included discussion of fraudulent transfer actions brought by the Trustee. Ex. 110 at 25-27.

FOIA Exemption 5

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42 [redacted]

FOIA Exemption 5

Before the conclusion of the second session, Becker stated that "the staff is asking the Commission for authority to prepare testimony and write a brief taking the position supporting the trustee on cash in, cash out, but saying the cash needs to be described in constant dollar terms." Ex. 109 at 18; *see also* Ex. 110 at 57. The Commission ultimately voted [redacted] not to object to the staff's recommendation of the Constant Dollar Approach to the net equity determination. Ex. 109 at 19; *see also* Ex. 110 at 8.

FOIA Exemption 5

On December 11, 2009, the Commission filed a brief in the bankruptcy court which stated that the SEC "support[ed] the Trustee's determination that net equity should not be based on the customers' last statements (the 'final account statement method')" and that the SEC "support[ed] *in part* the Trustee's determination that net equity should be based upon the amounts customers deposited in accounts with [BMLIS] less any amounts withdrawn (the 'cash-in/cash-out method')." Memorandum of Law of the SEC, Docket No. 1052, *SIPC v. BMIS*, dated Dec. 11, 2009, http://www.madofftrustee.com/CourtFilings.aspx (emphasis added). It also stated that the SEC's position was "that in determining customer claims under the cash-in/cash-out method, the amount of the payment should be calculated in constant dollars by adjusting for the effects of inflation (or deflation)," and that the Commission will, at the appropriate time, file a brief addressing why its position that claims should be calculated in constant dollars is consistent with SIPA and court decisions construing SIPA."[43] *Id.* at 1.

I. SIPC and the Trustee Did Not Support the Constant Dollar Approach

Neither SIPC nor the Trustee believed that the Constant Dollar Approach was appropriate. In response to questions about discussions that SIPC had with the SEC in the September 2009 timeframe, Harbeck explained to the OIG:

> The discussions were to use some measure of the time value of money in the calculation of individual customers' net equities. We believed -- when I say "we," the SIPC staff took a position as a matter of law that the net equity definition does not contain any allowance for the time value of money. . . .
>
> For example, any federal statute or any other statute which uses some sort of an inflation factor usually states a date from whence all calculations should be calculated and says that it will be done from that point forward. . . .

[43] The courts have not yet decided whether the Constant Dollar Approach, or any inflation adjustment, is appropriate in the Madoff Liquidation. Although the Second Circuit recently upheld the Trustee's position, *i.e.*, Money In/Money Out Method, it noted that "[t]he bankruptcy court reserved decision on the issue of whether the Net Investment Method should be adjusted to account for inflation or interest." *In re Bernard L. Madoff Investment Securities, LLC*, Case No. 10-2378 (2d Cir.), slip op. dated Aug. 16, 2011, at 13.

> Our statute and our net equity definition does not have such a provision.

Harbeck Interview Tr. at 43-44. Harbeck also stated that he specifically recalled telling Becker in a telephone conversation, during which Becker informed him that the Commission would use a Constant Dollar Approach, that there was no justification for such an approach under SIPA. Harbeck Interview Tr. at 46. Wang recalled a telephone call with Becker in which they discussed the Constant Dollar Approach, but she could not recall whether it was the first time SIPC had learned of the approach or whether it was communicated earlier. Wang Interview Tr. at 18. During that telephone call, Wang recalled "a great deal of skepticism [on SIPC's part] as to whether that position was supportable under the law." *Id.* She also recalled that Becker "offered an explanation as to how it would work," and "he said that as he was explaining it, it seemed to make even more sense to him." *Id.* at 19. *See also* Ex. 113; Ex. 114.

The Trustee also did not support the Constant Dollar or T-Bill Approach. When the SEC requested certain information from the Trustee to perform analyses under this approaches, the Trustee's counsel responded that this approach was not appropriate under the law, stating:

> As we have all acknowledged, we are dealing here with filberts or McGuffins that have no legal foundation in either the SIPA statute or the case law which, indeed, is to the contrary. Moreover, no matter what name we choose to give it or how many ways we try to recalculate it, in the end, it is still just interest on a net equity sum.

Ex. 115. As the Trustee explained to the OIG, he was against approaches that attempted to consider the time value of money because they were contrary to SIPA. Picard Interview Tr. at 25-26.

J. The Approach Used to Determine Net Equity Affects Clawbacks

Use of either the Last Account Statement Method or the Constant Dollar Approach would have a significant effect on the Trustee's clawback actions. While OGC Assistant General Counsel #1 viewed claims determination and clawbacks as "two different things," she explained that the net equity determination and how clawbacks are calculated are "all part of the same case" and "all part of the Madoff SIPA liquidation." OGC Assistant General Counsel #1 Testimony Tr. at 77. In the October 28, 2009 Advice Memorandum signed by Becker, OGC informed the Commission that "[c]alculating customers' claims based on the time-equivalent dollar value of the money that customers invested in and withdrew from their BMIS accounts could have an impact on the Trustee's avoidance actions seeking to recover, as preferences, or fraudulent transfers, payments made to customers prior to the firm's failure." Ex. 108 at 26.

In his OIG testimony, Becker effectively conceded that there was a relationship between the net equity determination and clawbacks, at least with respect to the Last Account Statement Method.

> Q. Did you have an understanding as to whether if the last account statement approach had been adopted, let's say the SEC had recommended that approach instead of the cash in/cash out modified by constant dollar, whether that would have had an impact on either how many clawback suits would be brought or how much would be sought in clawback suits?
>
> A. I had -- understanding overstates it. I had some, I don't know, you can call it sense that somehow some of this -- well, I had no sense on how it would affect the amount of money sought in clawback. I did have sort of a general, I don't know, feeling that it might have, could have, don't know, an impact on how many suits were brought.
>
> I mean, if you look at my May 4th memo to Bill Lenox, it basically says, here is what I know. Here is the issue before us. I don't think it has anything to do with me, but kind of out of an abundance of caution, it could have an impact -- how this is resolved could have an impact on the decision of the trustee to bring clawbacks or not. But beyond that, I didn't have any sense, no.

Becker Testimony Tr. at 64-65.

All four Commissioners testified that they understood that the method recommended by the Commission to determine net equity would affect the clawback actions brought by the Trustee, as demonstrated in the following testimony excerpts.

> Q. Now did you understand that depending upon which method the Commission decided would be the most appropriate, or depending on the method that the Commission advised SIPC it believed was the most appropriate, the different methods that would be adopted by the Commission would have an impact not just on the customers who lost money in Madoff, but also to the extent there would be clawbacks of other customers who gained profits in Madoff?

A. Yes. The discussion was whether to use the last statement balance or the cash-in and cash-out methodology, both of which resulted in different outcomes.

Q. Right. And those would then affect either the amount of money needed to be clawed back or potentially how many people would be clawed back[?]

A. Yes.

Aguilar Testimony Tr. at 18-19.

Q. Now with respect to the different approaches that were discussed -- there was the final account statement approach, the cash-in/cash-out method, and then the constant dollar approach. Did you understand that, depending on which approach was used -- would impact either the amount of money you needed to clawback or the amount of people that you clawed back against or otherwise affect the clawback part?

A. Yes, I guess it would have -- certainly would have affected the clawback as much at it would the amount that folks would have been eligible for in the first instance.

Casey Testimony Tr. at 13.

Q. Did you understand that depending on which method was utilized, would have an impact on either the amount of money you needed to clawback or potentially how many clawbacks would be sought by the trustee?

A. Yes, I did.

Walter Testimony Tr. at 18-19.

Q. Did you understand that in the determination of what method to use, there is several methods discussed in this advice memorandum: the final account statement method; cash-in/cash-out method; time equivalent dollar method, sometimes known as a constant dollar approach. Did you understand that depending on which one of those methods you used would then have an impact on either how much money would be available to be clawed back, how much

> money would be needed to be clawed back, or otherwise affecting the clawbacks?
>
> A. Yeah. It's hard to recall exactly what I knew or had in mind at the time, but my recollection, sitting here, is that I did have an understanding that there was an interplay between how one's claims were calculated would impact the claims as to the entirety of [the estate], and then of course, that could flow through in terms of clawback determinations and the like.

Paredes Testimony Tr. at 14-15. In addition, Chairman Schapiro testified that, on some level, she understood that using the Last Account Statement Method would have an impact on clawback suits, and that using the Constant Dollar Approach would result in having to pay out more money and that, logically, the Trustee would then need more clawback suits. Schapiro Testimony Tr. at 40-41, 53.

TM similarly understood the interplay between net equity and clawback suits. In a July 4, 2009 e-mail providing general guidance on clawback issues, Sr. TM Official stated that "money that is not clawed back means less recovery for other victims. Recent victims likely have not withdrawn much money and would likely prefer clawbacks from the customers that received some 'benefit' from the ponzi [*sic*] scheme." Ex. 116. Sr. TM Official agreed that in this e-mail, he was trying to explain that whatever is determined, in terms of the calculations for the claimants, has an impact on the clawbacks and vice versa. Sr. TM Official Testimony Tr. at 102.

Sr. TM Official "[a]bsolutely" agreed that under whatever method was used to calculate net equity, one would have to consider how that impacts clawbacks as part of the whole equation. Sr. TM Official Testimony Tr. at 49. Further, he agreed that the determination of how to assess the amount that the claimants are going to get is going to affect how many clawbacks there would be and how you would go about getting money against clawbacks. *Id.* Macchiaroli explained that the total amount of customer property available for distribution to Madoff's customers "would depend on how much you could claw back" because there was very little customer property available, and he viewed the ability to claw back as significant in terms of trying to figure out how much money investors could claim under SIPA. Macchiaroli Testimony Tr. at 28. However, Becker admitted that he did not consider whether, if the Trustee distributed more money in net equity claims, he potentially would need to claw back more in order to make everyone whole. Becker Testimony Tr. at 68.

SIPC's President and CEO explained to the OIG that all of the methods that were considered by Becker and the SEC staff while they determined what to recommend to the Commission regarding net equity could have impacted his status as a person facing a clawback action:

> A. Every proffered methodology, other than the one that was specifically agreed upon between all divisions of the SEC and at least three of the SEC commissioners, any deviation from that would have directly affected [Becker's] account and every proffered methodology would have improved [Becker's] financial position, or the financial position of the account.
>
> Q. In what way?
>
> A. By increasing the amount that the account was owed, he would theoretically decrease any amount which he could have -- the trustee could have received in a preference or fraudulent transfer action.

Harbeck Interview Tr. at 10.

1. The Last Account Statement Method Likely Would Preclude Clawbacks

One consequence of using the Last Account Statement Method was that it likely would preclude clawbacks. SEC personnel who were knowledgeable about SIPC and/or bankruptcy issues generally agreed with this principle. For example, Sr. TM Official testified that "the recoveries are much lower under the account statement value because you don't do the clawbacks." Sr. TM Official Testimony Tr. at 48. Macchiaroli testified as follows regarding the effect of the Last Account Statement Method on clawbacks:

> I think the whole clawback would be thrown out the window. . . . I don't see how you could claw back if people are relying on the account statement unless the account statement shows nothing. . . .
>
> [T]he whole Ponzi scheme thing would be thrown into chaos because a Ponzi scheme essentially depends on gathering all the available property and distributing it so everybody shares equally in the losses.

Macchiaroli Testimony Tr. at 37. 3) NYRO Assistant Regional Director said that under the Last Account Statement Method, "you couldn't just get sued for recovery of interest, because it would still probably be part of your claim." NYRO Assistant Regional Director Testimony Tr. at 73.

SIPC also agreed that the Trustee's clawback actions would be affected by the use of the Last Account Statement Method. Harbeck stated that fraudulent transfer actions, *i.e.*, clawback suits, would be "standing on far weaker grounds." Harbeck Interview Tr. at 35. SIPC's General Counsel also indicated that using the Last Account Statement Method could impact clawbacks because "it meant that the customer could rely on the

last account statement and could argue . . . that that was an ordinary course of business transaction, that the monies were -- the fake profits were received in good faith, and that value had been given." Wang Interview Tr. at 22.[44]

Becker recalled the position that the Last Account Statement Method would preclude clawbacks, testifying: "[T]here was some meeting with the trustee where among the 97 reasons – not literally – the many reasons they mentioned that last statement was a terrible idea was, 'Oh, and we couldn't do any clawbacks.' And I do remember not believing that. I thought that was kind of bombastic and self-serving." Becker Testimony Tr. at 68. During his testimony, Becker, however, acknowledged that whether the Last Account Statement Method would preclude clawbacks is a "[g]ood question [to which he did not] purport to know the answer authoritatively." *Id.* at 65.

2. The Constant Dollar Approach Would Affect Clawbacks

TM and SIPC officials explained that the Constant Dollar Approach would affect the amount that would be clawed back from any given individual. For example, Sr. TM Official agreed that a "net winner" who made money through his investment with Madoff would see the amount subject to clawback reduced by whatever inflation adjustment would be applied to the person's principal investment. Sr. TM Official Testimony Tr. at 90. He also agreed that if a Madoff customer like Becker had invested principal of $500,000 and withdrawn $2 million from the account overall, he would face a clawback suit for $1.5 million under the Money In/Money Out Method, but the amount of the clawback suit under a Constant Dollar Approach would be less than $1.5 million to take into account whatever inflation adjustment would be applied to the $500,000 principal investment. *Id.* Macchiaroli explained how a clawback claim would be less if the Constant Dollar Approach were applied:

> The claw backs would be less. You're entitled -- so you put in a million and say you kept it in for a year, so you would have been entitled to a million, whatever the inflation factor was, so 1,050,000. So you could not claw back -- anything less you could not claw back. That would be your starting point because we all agreed that you could not claw [back] principal, you could only claw back excess.
> ...
>
> Q. And this would basically add this time value of money component to the principal –

[44] However, Picard told the OIG that he thought clawback suits would still occur under the Last Account Statement Method, but he also acknowledged that the amount of clawback suits could be affected by use of the Last Account Statement Method. Picard Interview Tr. at 10. OGC Assistant General Counsel #1 also explained that clawback suits had to be treated separately from the claim determination, but conceded that it would all be part of the overall liquidation proceeding. OGC Assistant General Counsel #1 Testimony Tr. at 75-77.

A. That's right.

Q. -- and allow the net winners to retain that.

A . That's right. They could still claw back, but --

Q. Not as much.

A. But not as much, yeah.

Macchiaroli Testimony Tr. at 73.

SIPC's President explained that using a Constant Dollar Approach would reduce the amount of the clawback and detract from the distributions to customers:

> Q. Now with respect to the constant dollar approach, and just to be clear, is there an impact on someone in David Becker's position, given his mother's account that he inherited that account, of the use of a constant dollar approach, versus the money-in/money-out method?
>
> A. Yes. It would increase the principal, if you will, that would thus not be subject to a fraudulent transfer. And it would -- the other consequence of it was not just two people receiving a benefit of constant dollars, but again, because it would decrease the distribution to other customers, it would detract from what would -- what other people would get who had not been made [whole], for the benefit of people who had been A) made whole, and B) received fictitious profits.

Harbeck Interview Tr. at 46.

Becker disagreed with the concept that the method used to determine net equity would also be used to determine the amount to clawback, stating: "I'm morally certain that . . . if the courts finally rule that it's constant dollars, the trustee is not going to feel constrained in terms of the clawback actions that he'll bring." Becker Testimony Tr. at 65. His rationale for this position was the fact that clawback liability as a general bankruptcy principle under state law was not related to issues arising under SIPA. *Id.* at 66. He further testified that he had no understanding of whether the Trustee would also apply whatever method ruled to be applicable to determining claims, such as the Constant Dollar Approach, when determining how much to seek in clawbacks. *Id.* at 68.

3. The Constant Dollar Approach Would Decrease the Amount Sought from Becker

An analysis performed by Harbeck under the Constant Dollar Approach indicated that the amount sought in the clawback suit against Becker and his brothers would be reduced by approximately $140,000. Harbeck first mentioned this analysis to Chairman Schapiro shortly after the press coverage of the Becker clawback suit began. Harbeck Interview Mem. at 1; Schapiro Testimony Tr. at 72-73; Ex. 117. Harbeck said that he would have done "back of the envelope calculations" to determine the difference of bringing clawback suits under the Constant Dollar Approach, as opposed to another method. Harbeck Interview Mem. at 1. Harbeck explained that he would have performed the analysis by looking at the clawback complaint filed against Becker to determine what the fictitious profits/damages would be under the Money In/Money Out Method and then would calculate the amount by which that principal would be reduced under the Constant Dollar Approach. *Id.* The OIG made an effort to recreate this analysis based on this description and asked Harbeck to review the analysis. *Id.* at 2 and Ex. A thereto. The OIG's analysis calculated that a benefit of approximately $138,500 would result from applying the Constant Dollar Approach in the Becker clawback suit by adjusting the amount of principal invested of approximately $500,000 by a percentage inflation adjustment calculated from the Department of Labor's Bureau of Labor Statistics Consumer Price Index ("CPI") Table. Upon review, Harbeck, through his counsel, confirmed that it did approximate his methodology. *Id.* at 2 and Ex. B thereto. Counsel added that although Harbeck's analysis may have used a different multiplier, as opposed to the CPI data used by the OIG, "the concept, and the result, were the same." *Id.*

Although Becker did not review this specific analysis, he disagreed with the concept that applying the Constant Dollar Approach would result in a $140,000 reduction to the amount that the Trustee could seek to recover in the clawback suit against him and his brothers. Becker Testimony Tr. at 89. Becker testified: "I don't think [Harbeck's] correct. I think he's wrong, as a matter of law, [for] the reasons that I mentioned, or may be wrong as a matter of law, and I think his numbers are way off. They're way off because . . . [t]he amounts that they had thought I had gotten are way overestimated [and would have to, in any event, be] divided by three." *Id.* In any event, Becker testified that he "[a]bsolutely" did not make any attempt to put himself in a better financial position as a result of his work at the SEC, explaining: "I can say with some confidence that that never occurred to me. I'm not sure what I would have done if it had occurred to me. I don't know that I would have known how to put myself in a better financial position. . . . I sure did not use an instant of my time while I was at the SEC trying to improve my financial position." *Id.* at 88.

V. Becker Also Worked On SIPA Amendment That Would Have Affected the Trustee's Ability to Bring Clawbacks

On October 27, 2009, OLA Deputy Director #1 of the SEC's Office of Intergovernmental and Legislative Affairs ("OLA") forwarded Becker a draft amendment

of a portion of SIPA, as well as TM's analysis of that proposal, and asked Becker if there was "any reason SEC staff should weigh in tomorrow on an amendment to be considered during a House Financial Services Committee markup regarding the ability of the SIPC trustee to do clawbacks[.]"[45] Ex. 118. The proposed amendment was entitled, "Clarification Regarding Liquidation Proceedings" and amended Section 6 of SIPA (15 U.S.C. § 78fff) to add:

> Notwithstanding any other provision of this Act, no action under Sections 544, 547, or 548 of title 11, United States Code, may be brought against a customer of a registered broker or dealer to recover funds received representing either principal or income on the customer's account absent proof that the customer did not have a legitimate expectation that the assets in his account belonged to him.

Id. As discussed in Section I.A *supra*, Sections 544, 547, and 548 are the provisions that allow a SIPA trustee to bring clawback actions, and, accordingly, this amendment, if enacted, would have precluded the Trustee from bringing clawback actions like that against Becker, which were the majority of the clawback suits brought, *i.e.*, suits that did not rely on any knowledge of the alleged wrongdoing.

Becker responded to OLA Deputy Director #1 later that day, stating:

> It's incomprehensible: it's [*sic*] effects are either huge or zero. I take it the intention is to prevent all preference actions in SIPC proceedings except where it can be proven that the customer somehow acted in bad faith. If that's it, it's a huge change in the bankruptcy law, which is a bit beyond me. It basically prevents Trustees from redistributing assets from those who already have them to . . . those who don't, and it doesn't seem fair to me.

Ex. 120. Becker did not recall sending his e-mail, but did not dispute that he sent it. Becker Testimony Tr. at 72.

Our investigation did not identify specific documentation that SEC staff ultimately provided on this proposed amendment, which was withdrawn a few days later. Markup, Discussion Draft, Investor Protection Act of 2009 (to be reported as H.R. 3817), October 27 and 28, November 3 and 4, 2009, at www.financialservices.house.gov; *see*

[45] OLA Deputy Director #1 previously received a request from the staff of the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises to provide comments on this and another proposed SIPA amendment. Ex. 119. The staff described the amendment as "prevent[ing] the trustee from clawing back any funds from a customer had did not have a legitimate expectation that the assets belonged to him." *Id.*

also Ex. 119. However, Sr. TM Official testified that his recollection was that the SEC staff did weigh in on the amendment, which they viewed as being "very problematic," and that the bill was not passed. Sr. TM Official Testimony Tr. at 108-09.

Becker testified that he was not sure that what he said in this e-mail "rises to the level of advice." Becker Testimony Tr. at 72. However, he also testified that he would have to consider whether there would be a potential conflict of interest, or an appearance thereof, if he provided advice regarding a SIPA amendment that would limit the ability of a SIPA trustee to bring clawback actions. *Id.* However, he stated that he did not "take these seriously as things that might, in fact, happen" because there is a "certain amount of political grandstanding that went on for the benefit of [Congressional] constituents who were at risk." *Id.* at 73. *See also id.* at 74 (he regarded this amendment as "essentially political noise."). Becker did not believe that he sought ethics advice regarding providing advice on amendments to SIPA. *Id.* at 72-73. Becker further testified that he did not recall thinking about conflict or appearance issues arising from his provision of comment on amendments to SIPA.[46] *Id.* at 73.

VI. Becker Was Initially Scheduled to Testify at a Congressional Hearing Regarding Madoff/SIPC Issues

On or around October 23, 2009, the SEC, through OLA, learned that the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises was scheduling a hearing on SIPC and the Madoff victims. Ex. 121. OLA Deputy Director #1 of OLA forwarded an e-mail from the subcommittee to Becker and Hu, and Becker responded asking if she knew on what issues the subcommittee would focus. *Id.* OLA Deputy Director #1 also informed Chairman Schapiro, her staff, others in OLA, and Becker that the hearing was tentatively being scheduled for November 19, 2009. Ex. 122. Chairman Schapiro initially suggested that Gallagher was probably the best witness. *Id.* She testified that her suggestion was because SIPC was part of Gallagher's responsibility. Schapiro Testimony Tr. at 60.

Shortly thereafter, the SEC learned that the Congressional testimony would focus on legal aspects of the SIPC/Madoff issues. Spitler Testimony Tr. at 13-14. Chairman Schapiro sent an e-mail to Becker regarding the hearing, stating: "I wonder if it makes sense for you to testify . . . ." Ex. 123. Becker responded: "In truth, I think it depends on what the hearing is likely to be about. If it makes sense, I'd of course do it . . . ." *Id.* Chairman Schapiro stated that she did not think Becker liked to testify and noted that he never testified before Congress during his tenure as General Counsel. Schapiro Testimony Tr. at 61. Her view was that the testimony concerned "very specific legal

[46] Commissioner Aguilar testified that he would have advised Becker to recuse himself from giving advice on a statute that would completely outlaw clawbacks, if he was aware that there was a possibility that he could be subject to a clawback suit because of his mother's estate's account. Aguilar Testimony Tr. at 19-20.

issues" dealing with interpretation of SIPA and related caselaw, making it "a particularly legal sort of a hearing." *Id.*

After the Chairman's suggestion and by November 2, 2009, it was generally understood that Becker would be the Commission's witness at the subcommittee hearing. Becker testified that he thought there was "a consensus that [he] was the logical person to testify." Becker Testimony Tr. at 77. Contemporaneous documents established this fact. *See, e.g.*, Ex. 124 ("I think David Becker will be the witness because it is focused on SIPC matters involved in Madoff."); Ex. 125 ("The House Madoff/SIPC hearing is going to focus on the legal arguments on SIPC, so Becker will be the lucky one to testify.").[47]

On November 3, 2009, OLA Director Spitler sent an e-mail to Becker regarding his upcoming testimony:

> This is to follow up on our conversation yesterday about your testifying on behalf of the Commission at a hearing by the House Capital Markets Subcommittee on November 19. The topic of the hearing is to discuss the interaction of Madoff victims with SIPC, especially competing theories of distribution, clawbacks, etc. . . .
>
> Our sense is that the testimony should probably start off with a brief general description of SIPC and how it works followed by a description of SIPC's role with regard to the Madoff victims. There also should probably be discussion of the different potential methods of distribution and a statement of the Commission's preferred approach if we have guidance from the Commission.

Ex. 126. Becker forwarded this e-mail to various OGC personnel, stating, "This is plainly an added burden that nobody needs. Having said that, I'd like to avoid

[47] *See also* OLA Deputy Director #2 Testimony Tr. at 12 ("my memory is that David Becker initially was going to be the witness"), at 13 ("Q. So it seems clear and is it your recollection that initially the idea was for David Becker to testify at this hearing? A. That is my memory, yes, that Mr. Becker would be the witness.") and at 14 ("Again, that's consistent with my memory that Mr. Becker initially was going to be the Commission's witness."); Spitler Testimony Tr. at 15 ("Q. So at this point in time as of November 2nd, this is when you were describing earlier that David Becker was the initial person to be the witness[?] A. Yes.") and at 20 ("So it's clear though, as of November 4, 2009, that David Becker was still the intended person to testify[?] A. Yes. Yeah."); OGC Assistant General Counsel #1 Testimony Tr. at 107 ("initially David was going to do the testimony"); Conley Testimony Tr. at 42 ("Q. It looks like from this e-mail string, the testimony that you described earlier, David Becker was initially going to testify at that hearing, right? A. That's correct.").

publication if at all possible, and I'll need some help."[48] Ex. 127. He asked to meet the following day to discuss the testimony. *Id.*

OGC and OLA then began the process of drafting and preparing testimony for Becker to provide at the subcommittee hearing. On November 4, 2009, Conley e-mailed Spitler and OLA Deputy Director #2, copying Becker and others in OGC, an outline for Becker's testimony and stated that he anticipated a draft by November 10, 2009. Ex. 128. The outline indicated that the testimony would address the effect of the various approaches for distributions to claimants. *Id.* Various contemporaneous documents established that the plan was that Becker would testify on behalf of the Commission. Ex. 129 (referring to "David [Becker]'s congressional testimony on November 19th"); Ex. 130 ("I'm working on drafting David [Becker]'s testimony for the Capital Markets Subcommittee hearing."); Ex. 131 (referencing "DB Testimony"); Ex. 132 (attaching draft David M. Becker testimony re: Madoff/SIPC).

A. Subsequently, It Was Determined that Becker Would Disclose His Madoff Interest If He Were to Testify, and the Decision Was Made for Becker Not to Testify

At some point after the initial determination that Becker would testify at the subcommittee hearing, Becker discussed the proposed testimony with Spitler. Becker stated that he approached Spitler because he "shouldn't be [his] own counselor with respect to any risk [to] the Commission if [he] were the one who testifies." Becker Testimony Tr. at 77. Becker explained that he informed Spitler that his mother had a Madoff account from which he "had gotten an inheritance." *Id.* He stated that he also told Spitler that he had discussed the issue with SEC Ethics Counsel Lenox and was "perfectly prepared to testify," and that he wanted Spitler to know about this fact in case Spitler did not think he should testify. *Id.* Becker's recollection was that Spitler considered the question for a few minutes and concluded that he could not think of any reason why Becker should not testify. *Id.* Becker also explained that at some point, whether in this conversation or one that followed, ". . . I said, 'Of course, if I do testify, I would put at the beginning, I would mention my, the fact of my mother's account with Madoff.' Because . . . I would want to take any nondisclosure issue off the table." *Id.* at 78.

Spitler recalled as follows regarding his conversation with Becker:

> He . . . told me . . . that his . . . mother had had, I guess, an investment with Madoff that . . . when she passed away, as part of her estate, he and his brother had inherited money from that, that the chairman was aware of that and that he had also communicated that to the Ethics office, and they

[48] Becker could not recall what he meant by the phrase "avoid publication," and others in OGC did not recall what he meant. Becker Testimony Tr. at 75-76; *see also* Cahn Testimony Tr. at 28-30; Conley Testimony Tr. at 42.

> had cleared him to work on Madoff issues. But he wanted me to know that as I was making decisions about who should represent the Commission.

Spitler Testimony Tr. at 9-10. Spitler's understanding was that Becker "thought those were facts [he] should know before [he] made a decision, final decision about who should be the witness." *Id.* at 31. Spitler also recalled that during that conversation, he asked Becker who would be a good choice to testify, if it were not Becker, and Becker identified Michael Conley. *Id.* at 24-25. However, Spitler also testified that he "got the sense that it was [Becker's] preference that someone else testify." *Id.* at 31. Spitler further stated that Becker indicated that if Spitler thought Becker "was still the best witness, then that would be fine, but [Becker] was clearly making it clear to [him] that if [he] though[t] [Becker] wasn't the best witness, that that was not going to be a problem either." *Id.* at 31. Spitler also testified that he told Becker that he "wanted a little time to think about what [Becker] had told [him]," and he then "took some time to think about what that might mean for him as a witness." *Id.* at 10.

Becker testified that after this conversation, Spitler contacted him later in the day and said, "You know, now that I think about it, I think it would be better if somebody else testified. My concern is – not that there's anything inappropriate, but my concern is [ ] that when you're in a political environment, people might want to make something of that, and it would be a distraction rather than focusing on what the Commission's position was and why." Becker Testimony Tr. at 78. According to Becker, Spitler said that he was going to discuss the issue with the Chairman to confirm his view.[49] *Id.*

Becker testified that either the evening of his conversation with Spitler or the following morning, he spoke with Chairman Schapiro about his mother's account. Becker Tr. at 78-79. Chairman Schapiro recalled the conversation with Becker, although she could not recall the exact date or whether anyone else was present for that conversation. Schapiro Testimony Tr. at 62. She described the conversation as follows:

> I recall saying that if David [Becker] did testify, we needed to make it absolutely clear to Congress that there was this connection, remote though I believed it to be, that his long-deceased mother had had an account at Madoff, so that nobody would be surprised by that, so that we were completely forthcoming with Congress.

Id. Chairman Schapiro did not recall whether Becker said anything in response to her statement. *Id.* Chairman Schapiro further testified:

[49] Although Spitler did not testify regarding this later conversation with Becker, he did testify that he ultimately concluded that Becker should not testify. Spitler Testimony Tr. at 26.

> Q. Now when you suggested that if David Becker were to testify the -- his mother's Madoff account with Madoff would have to be disclosed, was that something that you raised initially, or was it something that David Becker raised? Did you --
>
> A. I believe I raised it . . . because I have had this view that we have to be completely forthcoming with Congress, that there's never a good reason not to be. . . . And I just didn't want there to be surprises . . . .

Id. at 63. Chairman Schapiro did not recall how the issue was resolved, other than that Conley ultimately served as the Commission's witness. *Id.* at 62, 63.

Becker recalled that when he spoke to the Chairman, she said that she had spoken with Spitler and agreed with him that it would be better if someone else were to testify.[50] Becker Testimony Tr. at 79. Becker recalled telling the Chairman that he wanted to make clear that he was "perfectly willing to do this" and was not trying to take the easy way out, and that the Chairman laughed and said, "Don't worry. We'll find plenty of other occasions for you to testify," and continued to tease him about that over the next year or so. *Id.* When asked whether he recalled the Chairman also saying that if he were to testify, she would want him to disclose his mother's account with Madoff, Becker stated that he did not recall that and said, "I told her that was what I was going to do. I'm crystal clear about that. . . . I can't tell you how certain I am that it was I who told the Chairman that I would disclose this rather than her telling me I would have to disclose it. . . . I don't have the words to describe my degree of certainty because it is so great. . . . I am quite certain." *Id.* at 79-81. Becker also testified that during this conversation with Chairman Schapiro, "she asked who might do [the testimony], and [he] told her [he] thought . . . Michael Conley would do a terrific job."[51] *Id.* at 79.

Spitler testified that after he had considered the issue, he had a conversation with Chairman Schapiro about whether Becker should testify.[52] Spitler testified as follows regarding this conversation:

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[50] The Chairman did not recall discussing this issue with Spitler, but said it was possible she had a conversation with him about it. Schapiro Testimony Tr. at 81-82. Spitler did recall speaking with the Chairman. *Id.* at 21-22.

[51] Spitler also testified that his recollection was "that when David Becker told me that -- about the issue with his mother's estate that I had asked, you know, if he was not the witness, who might be a good witness. And I think -- my recollection is that he said Michael Conley would be a possibly good choice." Spitler Testimony Tr. at 24.

[52] Although he could not recall exact dates, Spitler testified that his conversation with Becker about his mother's account occurred after the initial November 2, 2009 conversation referenced in Exhibit 126, and that his conversation with the Chairman occurred after his second conversation with Becker. Spitler Testimony Tr. at 16, 21. Spitler sent an e-mail to the Chairman's office on Saturday, November 7, 2009

> I remember it being a relatively short conversation where I told her that David [Becker] had come to me and told me about his mother's account with Madoff, that I had thought about it and that even though, as I understood it, the Ethics people had signed off, that I didn't think that he would be the best witness for the Commission and that I thought Michael Conley would be a better witness.
>
> * * *
>
> The chairman basically said something to the effect of, "Fine," or whatever I thought was best. I understood it to mean my decision, but I was -- I wanted to make sure she knew about it.

Spitler Testimony Tr. at 21-22.

Spitler testified that he did not recall discussing whether, if Becker testified, he would have to disclose to Congress his interest in a Madoff account, explaining, "[i]n my mind my recollection is I didn't get to that level because I was operating with the assumption that, assuming everything was true, that it had been cleared by the Ethics counsel and everything else, would I still want him to be the witness[?] And once I reached the conclusion that even with those facts as given that I didn't want him to be the witness, I didn't have to get to the question of whether he should disclose." Spitler Testimony Tr. at 26. However, Spitler's rationale for Becker not being the witness referred specifically to the possibility of Becker's mother's account being a distraction, which would only be the case if the connection were made public. He testified, "The ultimate reasoning and basis for my decision was that this was -- this was a hearing that was going to involve Madoff victims. I didn't have any kind of sense at all about how this information that involved Mr. Becker would impact the hearing if -- if it came out either through disclosure or any other way." *Id.* at 32.

The OIG investigation concluded that regardless of who determined Becker's Madoff interest would have to be disclosed were Becker to testify, the decision that Becker would not serve as a witness was made in large part because he would have disclosed the fact that his mother had held a Madoff account if he testified. This conclusion is supported by certain draft Congressional responses prepared by personnel in OGC, with input from OLA.[53] Various iterations of the draft discussed a "consensus that if Mr. Becker were to testify, then he should disclose the fact that he was a beneficiary of his mother's estate's former interest in a Madoff account." Ex. 134.

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asking for a meeting with the Chairman to discuss "an upcoming testimony," which the Chairman's office scheduled for Monday, November 9, 2009, although Spitler did not recall whether that meeting related to whether Becker should testify. Ex. 133; Spitler Testimony Tr. at 21.

[53] The March 2011 Congressional responses are discussed in more detail in Section VIII *infra*.

B. It Was Decided that Conley Would Testify at the Congressional Hearing, and Becker's Interest in a Madoff Account Was Not Disclosed

By no later than November 10, 2009, the decision had been made that Michael Conley would be the Commission's witness, rather than Becker. Ex. 135 (attaching draft testimony titled "Statement of Michael A. Conley, Deputy Solicitor . . ."). [54] After the decision had been made for Conley to testify, Becker also disclosed his mother's Madoff account to Conley sometime in early November 2009. Conley Testimony Tr. at 11; Becker Testimony Tr. at 82. Conley testified, "[Becker] said that his mother had died, I believe in 2004, and had a Madoff account which was then liquidated and that he and his brothers had inherited from that account and that he believed this could be a distraction in the upcoming testimony and therefore asked . . . if I would present the testimony." Conley Testimony Tr. at 12. *See also id.* at 44 ("he did tell me about his mother and said that this would be a distraction and so that was the basis for asking me to testify."). Conley agreed to provide the testimony regarding the SIPC liquidation proceeding.[55] *Id.* at 43. Conley, in fact, testified at the subcommittee hearing, which was postponed and ultimately occurred on December 9, 2009,[56] and Becker's Madoff interest was not disclosed to Congress at that time.

During this November 2009 timeframe, the fact of Becker's interest in his mother's estate's Madoff account was not disclosed to the Commissioners or the bankruptcy court for the Madoff Liquidation, notwithstanding the fact that the Commission was considering Becker's recommendation on the net equity position to take in court at this very time. Becker testified that at that point, "[he] didn't see any particular occasion to disclose it to the other commissioners" and that it "never crossed [his] mind."[57] Becker Testimony Tr. at 81. Spitler also testified that he did not consider informing the Commissioners of this fact. Spitler Testimony Tr. at 35-36. Conley testified that, other than telling OGC Assistant General Counsel #1 about the account, he

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[54] *See also* Spitler Testimony Tr. at 24 ("Q. So it seems at least by November 10, 2009, that Michael Conley was going to testify, not David Becker. A. Yes."); OLA Deputy Director #2 Testimony Tr. at 16 ("I do recall learning that there was some sort of issue with respect to Mr. Becker and that as a result, Michael Conley would be a more appropriate witness.").

[55] Conley testified that he told OGC Assistant General Counsel #1 that he would be testifying before Congress and that he specifically told her that Becker's mother had a Madoff account. Conley Testimony Tr. at 12-13, 44. He testified that OGC Assistant General Counsel #1 had no reaction to that information other than with regard to Conley "having to present the testimony." *Id.* at 13. However, OGC Assistant General Counsel #1 testified that she did not learn about Becker's mother's account until it was made public in the press in February 2011. OGC Assistant General Counsel #1 Testimony Tr. at 16-17.

[56] Additional Reforms to the Securities Investor Protection Act, Serial No. 111-94 at 40-42 (Dec. 9, 2009), *at* http://financialservices.house.gov/Media/file/hearings/111/Printed%20Hearings/111-94.pdf ("Hearing Transcript").

[57] Becker also testified that he did not consider disclosure to the bankruptcy court handling the Madoff Liquidation and explained that it was not called for under these circumstances, as he did "not believe . . . that [he] had a stake in those proceedings." Becker Testimony Tr. at 82.

did not take any other actions upon Becker informing him about the account. Conley Testimony Tr. at 14.

However, several witnesses testified that disclosure to the Commission would have been appropriate in light of the fact that it was determined that Becker would disclose his interest in a Madoff account if he were to testify. For example, OLA Deputy Director #2 testified that he thought it was a "fair point that if Mr. Becker was going to be presenting to the Commission [on] this issue, that the issue [of Becker's mother's account] be disclosed." OLA Deputy Director #2 Testimony Tr. at 49. Current SEC General Counsel Cahn agreed that disclosure to the Commission would not have been inappropriate and might have been advisable, although he did not say that there should have been disclosure. Cahn Testimony Tr. at 55. Commissioner Casey testified that she would want to understand what the rationale was for determining that disclosure of Becker's interest would be relevant to his Congressional testimony but not to his providing advice to the Commission on the same issue. Casey Testimony Tr. at 15-16. Commissioner Aguilar testified that it was "incredibly surprising and incredibly disappointing that there was enough awareness to know that the conflict existed to prevent [Becker] from giving [this] testimony, yet the decision-makers at the Commission were not provided that information." Aguilar Testimony Tr. at 12.

C. The Hearing, Including the Preparation Process, Involved Consideration of Clawbacks

As noted above, the initial communication from the House subcommittee indicated that the hearing would discuss clawbacks. Ex. 121. At this time, it was understood that whoever testified at the hearing would have to be able to discuss clawbacks. *See, e.g.*, OLA Deputy Director #2 Testimony Tr. at 22-23. Spitler testified that he did not know much about clawbacks at that time, as he was relatively new to the Commission, but that he "knew that they were interested in all of the various issues about how the proceeds might be recovered and how they might be distributed . . . [i]ncluding clawbacks." Spitler Testimony Tr. at 11-12.

The invitation to appear before the House subcommittee also contained reference to clawbacks. The hearing was entitled "Additional Reforms to the Securities Investor Protection Act," and it asked that written testimony focus on, among other things, "[p]rohibiting any recovery of principal or interest from an investor without proof that the investor did not have a legitimate expectation that the assets belonged to him or her." Ex. 136. Upon receipt of the invitation, OLA Deputy Director #2 indicated to Conley that he had "previously flagged" most, if not all, of the proposed reforms and asked TM to make sure that Conley had all the materials he needed to speak to these issues. *Id.* Indeed, OLA Deputy Director #2 already had forwarded Conley an October 28, 2009 e-mail exchange regarding the substance of an amendment which proposed prohibiting clawbacks, as described in the hearing invitation. Ex. 137. He also forwarded Conley a link to the text of the amendment itself. Ex. 119.

The preparation process included discussion of clawbacks. Spitler Testimony Tr. at 38-39; OLA Deputy Director #2 Testimony Tr. at 21-23. In a December 3, 2009 e-mail, OLA Deputy Director #2 questioned, based upon a comment from one of the Chairman's counsels, whether a certain statement in the draft testimony was accurate, *i.e.*, that the total pool of customer money would not be altered by whichever approach the court adopted. Ex. 138. OGC Assistant General Counsel #1 responded as follows and discussed the interplay between clawbacks and net equity:

> I don't think the statement is accurate if the comparison is between cash-in/cash-out method and final account statement method. If you satisfy customer claims for net equity based upon the fictitious profits on the account statements, the court will not let you bring avoidance actions to recover payments for fictitious profits prior to the liquidation proceeding. This will curtail the amount of money that can be recovered for the fund of customer property. Thus, cash-in/cash-out means lots of money recovered for fund of customer property; final account statement potentially means a lot less money recovered.
>
> The statement is accurate when the comparison is between SIPC's cash-in/cash-out and our constant dollar approach. Constant dollars should not have a significant effect on recoveries for the fund of customer property because there would be no payments for fictitious profits. SIPC, however, would probably argue that the amount of customer property recovered would be less because some of the money that might be considered recoverable fictitious profits would represent an inflation adjustment.

Id. Spitler asked OLA Deputy Director #2 to make sure to explore this issue in the next prep session. *Id.*

The hearing itself included discussion of clawbacks, both in written testimony and in the oral statements and questions. For example, Harbeck, who also testified at the hearing, addressed SIPC's views on various proposals for improving SIPA, including prohibiting any recovery of principal or interest without proof that the investor did not have a legitimate expectation that the assets belonged to him. The written testimony of law professor John C. Coffee addressed, among other things, the same proposal. Hearing Transcript at 96-101, 125. Both Harbeck and Coffee discussed the issue of clawbacks during the hearing itself, as reflected in the transcript. *See id.* at 21-22, 44, 50. Conley's written statement did not address clawbacks, and he did not receive any questions regarding clawbacks during the hearing. *Id.* at 40-42, 57-58, 104-118.

VII. Becker Was Named as Defendant in A Clawback Action

On December 1, 2010, the Trustee filed a complaint against the estate of Dorothy Becker and against David M. Becker and his two brothers as individuals and in their capacities as co-executors of her estate. *See* Ex. 139. The complaint was dated November 12, 2010. Ex. 140. That complaint asserted claims of fraudulent transfer and sought recovery of all amounts that constituted fictitious profits, approximately $1.5 million. *Id.* ¶ 40. The bankruptcy court issued the summons in that case on February 9, 2011, and the Trustee, through his counsel, served the complaint via United States First Class Mail on February 10, 2011. Ex. 141. The Trustee testified that this lag, both between the date on the complaint and the date it was filed and between the date of filing and the date of service, was not atypical, noting, "There was a lag, yes. Many of the complaints were filed in advance of the date when they were filed [*sic*]. And then subsequently there was a lag in the dates when the summonses were issued by the bankruptcy court." Picard Interview Tr. at 11. Picard further explained that with respect to Becker, the Trustee likely did not receive the summons from the bankruptcy court until a few days before it was served in February 2011, which was consistent with the docket. *Id; see also* Ex. 141.

On February 22, 2011, the New York Daily News ran an article connecting Becker to the clawback suit filed against him and his brothers. It stated: "The family of the top lawyer at the Securities and Exchange Commission invested with Bernie Madoff and earned more than $1.5 million in ill-gained profits, according to trustee Irving Picard, who has named the lawyer, David M. Becker, as a defendant in a clawback lawsuit, a Daily News investigation has found." *Irving Picard hits Securities and Exchange Commission's top lawyer with Bernie Madoff lawsuit*, NY Daily News, Feb. 22, 2011, http://articles.nydailynews.com/2011-02-22/sports/29442051_1_helen-davis-chaitman-irving-picard-madoff-account. Becker testified that he recalled first learning that he had been named as a defendant in a clawback suit when he read about it on the sports page of the New York Daily News. Becker Testimony Tr. at 83. He also recalled being asked for comment from members of the press.[58] *Id.* Other press coverage of the clawback suit followed shortly thereafter.[59]

Other than the individuals identified and discussed below, numerous SEC personnel learned of the clawback suit, and Becker's connection to Madoff, via this press coverage. None of the Commissioners, other than Chairman Schapiro, was aware of the

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[58] For example, on February 22, 2011, the SEC received inquiries from the New York Daily News seeking confirmation that Becker was "the same David Becker named in one of the SIPC trustee's clawback lawsuits (as executor of mother's estate)." Ex. 142.

[59] *See, e.g.*, Bruce Golding & Tom Perone, *SEC-Madoff Shock – Top Lawyer and His Bros Inherited $1.5M in Berniebucks*, N.Y. Post, Feb. 23, 2011, at 7; Peter Lattman, *Top S.E.C. Lawyer Sued by Madoff Trustee*, N.Y. Times Dealbook, Feb. 23, 2011, http://dealbook.nytimes.com/2011/02/23/top-s-e-c-lawyer-sued-by-madoff-trustee/?ref=securitiesandexchangecommission; David S. Hilzenrath, *Madoff victims' trustee sues SEC lawyer*, Washington Post, Feb. 24, 2011, at A12.

account prior to the press coverage, and the four Commissioners were surprised to learn the news,[60] as demonstrated by the following testimony:

> Q. When did you first become aware that David Becker's mother's estate held a Madoff account?
>
> A. I don't have a precise date. I think I read it. It was in the press – . . . was the first time I became aware of the issue.
>
> Q. Okay. So it was approximately around February 2011? That's when the –
>
> A. Whenever the press first reported on that.
>
> Q. . . . What was your reaction to learning the news?
>
> A. I was surprised by the revelation.

Casey Testimony Tr. at 6-7.

> Q. And when did you first become aware that David Becker's mother's estate held a Madoff account?
>
> A. When I heard about it after he was sued.
>
> Q. Okay. So when it became an issue in the press around February of 2011?
>
> A. . . . I don't recall that specifically. But it was at that time.
>
> Q. Okay. All right. What was your reaction to learning that?
>
> A. Surprise.

Walter Testimony Tr. at 8-9.

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[60] Chairman Schapiro testified that after Becker's mother's account became public, she had conversations with the Commissions about the account: "I went to tell each of the commissioners that I was deeply sorry that this had happened and that I never connected the dots. I never put together, again, this -- you know, years-ago closed liquidated account of his mother with the decision-making that the Commission was doing and that I was profoundly sorry to them for the -- you know, profoundly sorry and apologized to them for -- for my not realizing that there was an issue here." Schapiro Testimony Tr. at 74.

Q. When did you first become aware that David Becker's mother's estate held the Madoff account?

A. To the best of my recollection it was, I think, basically contemporaneous with when it was known more broadly publicly. I don't recall having any prior knowledge as to that.

* * *

Q. Okay. What was your reaction to learning the news?

A. Well, it caught my attention I think in part because it was in the news.

Paredes Testimony Tr. at 6.

Q. When did you become aware that David Becker's mother's estate held the Madoff account?

A. I don't know the exact date. It would be the early part of this year. I read about it in the newspaper. . . . So whenever the newspaper story broke.

* * *

Q. And what was your reaction to learning this?

A. I was very surprised. It was information that I was unaware of. And given the number of discussions that my office, in particular, had with the Office of General Counsel with respect to the matters mentioned in the article, particularly the potential SIPC coverage under the Madoff account, and in particular the discussions that my office had with the Office of General Counsel as to whether or not to use the constant dollar adjustment for inflation dollars methodology [which] I was led to believe was not allowed because it was akin to interest, which I thought the law didn't allow.

I had quite a few conversations with the Office of General Counsel. . . . And so having had so many conversations and not to have been apprised of this potential conflict of interest was very surprising.

Aguilar Testimony Tr. at 7-8. Indeed, at the time he learned of Becker's account, Commissioner Aguilar drafted a brief statement reflecting his view of learning that Becker had inherited funds invested with Madoff. *Id.* at 9. It stated:

> Commissioner Aguilar first learned of David Becker's having inherited funds invested with Bernard Madoff from a February 23, 2011 media article describing the action by SIPA trustee Irving Picard to recover funds from Mr. Becker and his brothers. Commissioner Aguilar is dismayed that he was not informed of these facts earlier. In particular, Commissioner Aguilar would have considered it important to know, when the Commission deliberated what position to advocate in court regarding how to value the claims of Bernard Madoff's victims, that the Commission's General Counsel had previously redeemed an investment in the Madoff scheme.

Ex. 143; *see also* Aguilar Testimony Tr. at 9 (indicating that this statement reflected his view upon learning of Becker's investment with Madoff). Aguilar further testified that as a Commissioner, he relied upon OGC for unbiased advice, and that if the General Counsel had a personal interest in a clawback, that "absolutely" gave him concern as to whether the information he received was completely unbiased. *Id.* at 19.

SEC staff members similarly first learned of Becker's mother's account with Madoff when it was reported in the press. All the TM personnel who testified or were interviewed in our investigation stated that they first became aware that Becker's mother's estate had held a Madoff account at the time that it was reported publicly. Sr. TM Official Testimony Tr. at 11; Macchiaroli Testimony Tr. at 10; Gallagher Interview Tr. at 6. Risk Fin and OLA staff testified similarly. Risk Fin Senior Official #1 Testimony Tr. at 11; OLA Deputy Director #1 Testimony Tr. at 7; OLA Deputy Director #2 Testimony Tr. at 9. OGC personnel who worked on the Madoff Liquidation also testified that they learned of the account through the media. Stillman Testimony Tr. at 7-8; OGC Assistant General Counsel #1 Testimony Tr. at 15-16 (*but see* n.55 *supra* discussing Conley's recollection of telling OGC Assistant General Counsel #1 about the account in or around November 2009).

SEC staff expressed their surprise as to learning about the account. For example, Sr. TM Official stated that he "was totally surprised" when he learned of the account and "had no idea." Sr. TM Official Testimony Tr. at 12. Gallagher stated that he was "surprised" and that "wasn't something [he] knew." Gallagher Interview Tr. at 6. Risk Fin Senior Official #1 stated that she "was surprised" and "was sorry to hear about it." Risk Fin Senior Official # 1 Testimony Tr. at 12. 34) NYRO Trial Counsel, of the Division of Enforcement in the SEC's New York Regional Office, testified that he was "just pretty surprised that he, given that, had any involvement in anything to do with the Madoff stuff at the SEC." NYRO Trial Counsel Testimony Tr. at 35-36.

Similarly, SIPC's President and General Counsel both learned of Becker's interest in his mother's estate's account with Madoff when that information was revealed publicly. Harbeck Interview Tr. at 8-9; Wang Interview Tr. at 6-7. Harbeck described that his initial reaction was "[s]erious concern." Harbeck Interview Tr. at 9. Wang explained that her reaction to the news was "[i]ntense surprise." Wang Interview Tr. at 7. The Trustee also learned of Becker's interest through a news account, and his reaction was surprise, as that information "had certainly never been disclosed to [him]."[61] Picard Interview Tr. at 6.

SIPC officials told the OIG that when they learned of Becker's interest in his mother's estate, they believed that his participation in the Madoff Liquidation would constitute a conflict of interest. Harbeck explained to the OIG:

> We had been dealing for over a year with Mr. Becker who did not recuse himself from discussions of matters which would clearly affect what that account would receive or would be subject to in terms of preferences or fraudulent transfers. . . .
>
> Indeed, we had asked Mr. Becker to recuse himself from discussions of matters involving Lehman Brothers. And he left the room when we were discussing Lehman Brothers because we knew that he was involved in his capacity as an attorney for Cleary with Lehman.
>
> Q. So how would you compare a possible conflict being an attorney for Cleary -- with Cleary for Lehman Brothers versus the financial interest he had in the Madoff matter?
>
> A. I think the financial interest he had in the Madoff thing is a far clearer conflict. . . . This is money in and out of his pocket.

Harbeck Interview Tr. at 9. The General Counsel explained that if SIPC had known of his involvement with his mother's estate's account, they would have asked that he be excluded from discussions on Madoff issues. Wang Interview Tr. at 7. She further stated that she believed that a person who inherited a Madoff account and thus potentially could have been subject to a clawback suit should not have worked on the Madoff Liquidation for the SEC. Wang Interview Tr. at 14-15.

[61] The Trustee also stated that his lawyers filed the clawback action against Becker and he was personally unaware of the specific suit until he saw the press reports. Picard Interview Tr. at 7-8.

The OIG's investigation identified several SEC personnel who were, in fact, aware of Becker's mother's estate's account prior to the press coverage of the clawback suit in February 2011. These personnel were: Chairman Schapiro, then-Deputy General Counsel and current General Counsel Mark Cahn, Deputy Solicitor Michael Conley, OLA Director Eric Spitler, Special Counsel to the Chairman Ricardo Delfin, then-Ethics Counsel Bill Lenox, and Assistant Ethics Counsel #3. This report addresses the knowledge and actions of Chairman Schapiro in sections III.B and VI.B, of Spitler in Section VI.B, and of Lenox and Assistant Ethics Counsel #3 in Section XI.C and D.

Cahn recalled a conversation with Becker sometime in approximately spring 2009, after Cahn had joined the Commission, in which Becker told him that his parents had had a Madoff account. Cahn Testimony Tr. at 12. Cahn also thought that Becker told him that the account had been liquidated to pay estate taxes, and that Cahn assumed that Becker was one of the beneficiaries of the estate. *Id.* at 12-13. Cahn also recalled generally that Becker told him that he either had or was going to discuss the account with Ethics Counsel. *Id.* at 13. He believed that the context of the discussion was that the SEC had been asked to become involved in the net equity issue, and Becker was "alerting [him] to the fact that we were going to be involved, or may become involved, in that matter, and this was something that either he had cleared through ethics or he would need to clear through ethics just to make sure he could participate in it." *Id.* Cahn also recalled that Becker mentioned that he had told the Chairman about the account, although he did not recall whether Becker specified exactly what he told the Chairman. *Id.* at 34. Cahn did not believe that he talked to anyone else about the fact that Becker's mother's estate had a Madoff account after his conversation with Becker. *Id.* at 14.

Conley testified that when he learned of Becker's mother's account (*see* Section VI.C), he was aware that Becker had been working on the SIPC liquidation for nine or ten months, and as he was familiar with the ethics procedures in place, he "assumed that [Becker] had, in fact, obtained clearance to work on [the matter]." Conley Testimony Tr. at 14. Conley did not have any conversation with Becker about him obtaining clearance or raising the issues with the Ethics Office and did not take any other action in response to the conversation with Becker. *Id.*

Delfin testified regarding a very brief conversation he had with Becker in May or June 2009 in which Becker referred to the fact that his mother had a Madoff account. Delfin Testimony Tr. at 6-7, 9-10. Delfin testified that at the time of this conversation, which occurred shortly after Delfin joined the Commission, Madoff was the "big issue" that the Commission was addressing. *Id.* at 6-7, 14. During this brief conversation with Becker, Delfin mentioned that he had a former colleague whose spouse's family had lost money investing with Madoff, and he wanted to flag that issue just to make sure he was not restricted from working on Madoff matters because of that connection. *Id.* at 12-13. In response, Becker said that his mother had a Madoff account. *Id.* at 9, 12. Delfin further testified that the implication he received from Becker's response was that he did not have to recuse himself from any Madoff matters, adding, "[C]ertainly the message was 'That's ridiculous. You don't have to recuse yourself. That's the dumbest thing I've

ever heard' -- was sort of the look of, 'You're a fool.' . . . And the sense I got was [Becker] had looked into it. He knows the rules, and it's done." *Id.* at 12.

VIII. The SEC Responded to March 2011 Congressional Requests for Information

On February 24, 2011, Chairman Schapiro received a letter from the Chairman and Vice Chairman of the House Financial Services Committee, the Chairman of the Subcommittee on Oversight and Investigations, and the Chairman of the Subcommittee on Capital Markets and Government Sponsored Enterprises. Ex. 144. That letter sought responses to questions regarding, among other things, Becker's awareness of the submissions of Harry Markopolos (discussed at Section X *infra*), his contacts with Madoff, his work on Madoff-related matters, and his communications with the SEC upon his February 2009 return regarding his mother's estate's account. *Id.* Becker responded to that February 24, 2011 letter at the Chairman's request. Ex. 61.

The initial draft of Becker's February 25, 2011 response was prepared by OGC Assistant General Counsel #2. OGC Assistant General Counsel #2 Testimony Tr. at 10; Ex. 145. She participated in a meeting with Becker and others to prepare for Congressional briefings and discussed through responses to the letter before circulating a draft for comment. OGC Assistant General Counsel #2 Testimony Tr. at 12-32; Ex. 146. She received edits from a variety of personnel, including Lenox and Becker. Ex. 145; Ex. 147.

On March 1, 2011, Chairman Schapiro received an additional letter from Chairman Bachus and others seeking answers to certain questions raised by Becker's February 25, 2001 letter. Ex. 148. Shortly thereafter, on March 3, 2011, Chairman Schapiro received a letter from the Chairman of the House Committee on Oversight and Government Reform and the Ranking Member of the Senate Committee on the Judiciary. Ex. 149. This letter requested additional information and documents regarding communications between Becker and the Chairman regarding Becker's mother's account, the ethics advice sought and received by Becker, and Becker's participation in various Madoff-related matters.

OGC was tasked with gathering information and drafting responses to March 1 and 3, 2011 letters. Cahn Testimony Tr. at 42-44; Ex. 150. OGC Assistant General Counsel #2 and OGC Attorney #1 worked to gather factual information by, among other things, interviewing and gathering information from Becker, Conley, Lenox, and Chairman Schapiro, collecting e-mails for review, and working with TM to obtain certain information from SIPC. OGC Assistant General Counsel #2 Testimony Tr. at 10, 30, 39, 50, 54-56.

Question 1 of the March 1, 2011 letter from Chairman Bachus noted that Becker's February 25, 2011 letter stated that he had informed Chairman Schapiro about his interest in his mother's Madoff account and stated: "Please detail the communication(s) between

you and Mr. Becker regarding his mother's Madoff account." Ex. 148. On Saturday, March 5, 2011, OGC Attorney #1 circulated an OGC draft of responses to the March 1 and 3, 2011 Congressional requests seeking comments from a Counsel to the Chairman, OLA Deputy Director #2, and Spitler of OLA, and Cahn. Ex. 151. That draft included the following language regarding a November or December 2009 discussion between Chairman Schapiro and Becker regarding Becker's mother's estate's account:

> Although I do not generally recall the specifics of the conversation, I do generally recall that Mr. Becker's mother's estate's account was mentioned in a discussion in or around November or December of 2009. Although I do not recall anyone else being present at that meeting, it is my understanding that Eric Spitler, the Director of our Office of Legislative and Intergovernmental Affairs, may also have participated in a part of that discussion. The SEC had been invited to provide a witness to testify before the House's Capital Markets and Government Sponsored Enterprises Subcommittee on the Commission's views on the liquidation of Bernie Madoff Investment Securities, LLC (BMIS) being conducted by the Securities Investor Protection Corporation (SIPC). The focus of the proposed testimony was to be a discussion of the principal legal authorities on the issue of how to establish the value of claims by Madoff customers. The referenced discussion was about who should testify on the SEC's analysis of that legal question. Even though Mr. Becker had no actual or apparent conflict of interest regarding Madoff matters in general or the particular Madoff issue that was the subject of the hearing, there was a consensus that if Mr. Becker testified, in the interest of full candor to the Congressional panel he would disclose his mother's estate's interest anyway. That disclosure may have become a distraction from the important subject matter at hand. It was ultimately decided that Michael Conley, the SEC's Deputy Solicitor, would testify. Mr. Conley is the Commission attorney most familiar with the issue because he is principally responsible for representing the SEC in court on matters related to that issue.

Id. at 3 and 4.[62] In a subsequent draft, certain additional edits were made to the language regarding the November 2009 discussion. Spitler suggested changing one sentence to

[62] Question 7 of the letter from Chairman Issa asked: "After Mr. Becker's initial disclosure to Chairman Schapiro that his late mother's estate had included proceeds from the Madoff Account, did Mr. Becker or Chairman Schapiro mention the matter to one another again? If so, when?" Ex. 149. The draft contained similar language to respond to this question and Question 1 of the letter from Chairman Bachus. *Id.* at 5.

read, "To ensure that there was no issue with regard to the impartiality of the Commission's testimony, it was ultimately decided . . . ." Ex. 152. Cahn also commented on whether Spitler's suggested language provided an accurate description of the Commission's thought process at that time. Ex. 153.

OGC Assistant General Counsel #2 then circulated a revised draft response to Cahn, OLA Deputy Director #2, Spitler, OGC Attorney #1, and Delfin. The language in question now read:

> In addition, although I do not recall the specifics of the conversation, I do generally recall that Mr. Becker's mother's estate's account was mentioned in a discussion in or around November or December of 2009. Although I do not recall anyone else being present at that meeting, it is my understanding that Eric Spitler, the Director of our Office of Legislative and Intergovernmental Affairs, may also have participated in a part of that discussion. The purpose of the conversation was to determine who should testify on behalf of the SEC at an upcoming hearing of the Capital Markets and Government Sponsored Enterprises Subcommittee of the House Financial Services Committee concerning the legal question of how to establish the value of claims by Madoff customers under the Securities Investor Protection Act (SIPA). In the course of that discussion, I recall there being a consensus that if Mr. Becker were to testify, then he should disclose the fact that he was a beneficiary of his mother's estate's former interest in a Madoff account. As the subject of the testimony was the Commission's decisions and legal recommendations, it was ultimately decided that the SEC's Deputy Solicitor, Michael Conley – one of the principal litigators representing the agency in the court's determination of that SIPA issue – would be the SEC's witness.

Ex. 134. Shortly thereafter, OLA Deputy Director #2 responded to the same group to discuss a plan for getting a draft to Chairman Schapiro for her review. Ex. 154. The OIG's investigation did not identify evidence that these drafts were circulated further after this time or that they were circulated to the Chairman.

Around this same timeframe, on March 4, 2011, Congressional staff requested confirmation from the SEC that the OIG would have primary responsibility for collecting documents and responding to their requests in their March 3, 2011 letter. Ex. 155. Additionally, the OIG raised concerns regarding the participation of OGC in responding to the Congressional inquiries. Cahn Testimony Tr. at 42; OLA Deputy Director #2 Testimony Tr. at 30. The OIG also emphasized to both OGC and the Chairman's office

the importance of not taking any steps that would interfere with the OIG's investigation and advised that any responses provided to specific questions should be limited and based only on personal knowledge. After consultation with Congressional staff and the OIG, it was ultimately determined that OGC would have no further involvement in collecting documents or drafting narrative responses to the Congressional inquiries. *Id.*; Cahn Testimony Tr. at 43-44. Late on Monday, March 7, 2011, Matt Martens and Joe Brenner, who were the Chief Litigation Counsel and Chief Counsel of the Division of Enforcement, respectively, were brought into the process to advise the Chairman in providing narrative responses to the inquiries. Cahn Testimony Tr. at 43-44; Brenner Testimony Tr. at 8; Martens Testimony Tr. at 8-9; *see* also Ex. 156. Accordingly, OGC was removed from the process and did not participate further in the drafting of the Chairman's responses. Cahn Testimony Tr. at 44; OLA Deputy Director #2 Testimony Tr. at 29, 60-61.

On the following morning, March 8, 2011, Martens and Brenner met with Chairman Schapiro to obtain her best recollection of the various issues raised in the two letters. Brenner Testimony Tr. at 8-9; Martens Testimony Tr. at 14-15; Ex. 157; *see also* Schapiro Testimony Tr. at 69. Their notes of this meeting reflect that Chairman Schapiro indicated that she recalled telling Becker that if he were to testify at the SIPC hearing, he should disclose his interest in his mother's estate's Madoff account. Ex. 117 at 1, 2("MS suggested that DB simply disclose the closed acct" and "MS did advise DB that if he testified he would need to disclose to Congress his Madoff connection"); Martens Testimony Tr. at 22 ("Q. So it was clear from the interview that you had with Mary Schapiro on March 8th that this issue about David Becker's mother's account was raised a second time in connection with the hearing before Congress? A. Correct. Q. And that at that time Mary Schapiro suggested that David Becker should disclose the account to Congress? A. That if he was going to testify he needed to disclose the account, correct."); Ex. 158 at 2 ("MS to DB: [I]f you testify, you have to make it clear [that you] have this connection w/Madoff. DB: [O]f course, absolutely"); Brenner Testimony Tr. at 15 ("Q. So it was clear from one of the conversations you had with Mary Schapiro that she was saying that she told David Becker that if he testifies, he has to in some way disclose his connection with Madoff? A. That's the substance. I can't remember the words exactly, but that was the substance I remember hearing at some point.").

However, the final versions of the Congressional responses were sent the same day that Brenner and Martens met with Chairman Schapiro, and did not reference to the fact that Becker was initially identified as the Commission's witness for the December 2009 hearing or that he was advised that he would have to disclose his mother's estate's Madoff account if he were to testify. The responses simply stated:

> After Mr. Becker provided the initial information to me regarding his mother's closed Madoff account, I recall having an additional discussion with Mr. Becker regarding the matter in the late fall of 2009. That discussion concerned the designation of Commission staff to testify

> before a congressional subcommittee regarding legal issues arising from the liquidation of Bernard L. Madoff Securities LLC being conducted by the Securities Investor Protection Corporation. During that discussion, either Mr. Becker or I referred to the information he had previously provided to me regarding his mother's closed Madoff account.

Ex. 62 at 2; *see* Ex. 63 at 2.[63]

Martens and Brenner both testified that after preparing a draft of the responses that reflected their understanding based on information from Chairman Schapiro, they did review OGC draft responses to make sure that they had not missed something. Martens Testimony Tr. at 13; Brenner Testimony Tr. at 20. Martens and Brenner did not recall that their review disclosed that they were missing anything significant. Martens Testimony Tr. at 13-14 ("we didn't see any glaring issue"); Brenner Testimony Tr. at 20 ("[t]here was nothing in there that seemed of th[e] sort of dramatic nature that would cause us to reconsider her current recollection of the events."). Although they could not say with certainty which OGC draft responses they reviewed, both Brenner and Martens agreed that the final version submitted to Congress did not include discussion of the fact that if Becker were to testify, he should disclose the fact of his mother's estate's interest in a Madoff account. Martens Testimony Tr. at 62, 65; Brenner Testimony Tr. at 25, 27-28.

Martens agreed that Chairman Schapiro had told Brenner and Martens that she recalled this fact, but could not remember why that information was not included in the final version of the letter. Martens Testimony Tr. at 64-65. Brenner also agreed regarding what Chairman Schapiro had told them about her recollection on this point, but was unsure whether she told them this before the letters were finalized. Brenner Testimony Tr. at 26. He also explained that the letters were not meant to "present an exhaustive list of every fact [the Chairman] might remember," but rather were "intended to be more of a high-level response based on her unrefreshed recollection to flag the time periods of conversations, the subject matters of conversations. . ." *Id.* at 26-27. Chairman Schapiro testified that in March 2011 when the Congressional responses were drafted, she was aware of the discussions that if David Becker were to testify at the Congressional hearing, he would have to disclose his Madoff connection, as she was the one who suggested it. Schapiro Testimony Tr. at 70; *see also id.* at 62-63. However, she could not remember the specific edit to the letter, but recalled trying to keep the letter general and ensure that it "didn't say anything we weren't sure of . . . ." *Id.* at 71.

[63] The responses noted that they were prepared without assistance from anyone in OGC and, because the Chairman had "not had an opportunity to review the relevant documents that the OIG may gather or otherwise refresh [her] recollection," her answers were "based on [her] best recollection of the events in question, some of which occurred as long ago as two years." Ex. 62 at 2; *see also* Ex. 63 at 2.

Neither Brenner nor Martens knew whether the Chairman or the SEC at any point informed Congress of the fact that, if Becker were to testify at the previous Congressional hearing, a decision or recommendation was made that he would have to disclose the fact that he was a beneficiary of his mother's estate's Madoff account. Martens Testimony Tr. at 66; Brenner Testimony Tr. at 28. The Chairman also was not aware of any communication to Congress of this fact. Schapiro Testimony Tr. at 72.

IX. Becker Worked On Other Madoff-Related Matters

The OIG investigation also reviewed whether Becker worked on other Madoff-related matters in addition to the net equity issues in the SIPC liquidation proceeding during his second tenure at the SEC.

A. Becker's Participation in Other Aspects of the Madoff Liquidation

Becker participated in several issues raised in the Madoff Liquidation other than the net equity determination. For example, the SEC and SIPC also had to consider what constituted a "customer" under SIPA, which was a defined term in the statute. *See* 15 U.S.C. § 78lll(2). From the outset, SIPC and TM flagged the definition of "customer" as an issue. Exs. 45 and 46. On June 23, 2010, OGC Assistant General Counsel #1 circulated to Becker and others a draft Action Memorandum on the issue of whether an investor in a "feeder fund" that had a BMIS account would be considered a customer in the Madoff Liquidation. Ex. 159. Becker provided "minimal comments" on the draft shortly thereafter. Ex. 160.

On July 8, 2010, the Commission considered the OGC's Action Memorandum on the feeder fund issue, which recommended that the Commission file a brief agreeing with the Trustee that only the feeder fund, and not its investors, is a customer entitled to payment from the SIPC Fund. Ex. 161. Becker attended that meeting and addressed several questions from the Commissioners. *Id.* The Commission voted to approve the recommendation with some modification, and the staff was to review the customer briefs once filed to determine if any footnote regarding a potential SIPC claim by feeder fund investors was warranted. *Id.* Thereafter, OGC Assistant General Counsel #1 circulated an additional memorandum to Becker and others addressing the briefs filed by the feeder fund investors and the Commission's concerns raised at the July 8, 2010 meeting and subsequently circulated a draft brief and Commission memorandum to Becker and Cahn. Ex. 162; Ex. 163. Becker provided "[j]ust a few comments on the brief" and "none on the memo." Ex. 164.

At a meeting on August 4, 2010 attended by Becker, the Commission approved OGC's recommendation that the Commission file a brief supporting the Trustee's motion to affirm his denial of the claims of investors in certain feeder funds. Ex. 165. On August 10, 2010, the SEC filed its brief supporting the Trustee's position. Mem. of Law of the SEC Supporting Trustee's Determinations Denying the Claims of Certain Feeder Fund Claimants, Docket No. 2849, *SIPC v. BMIS*, No. 08-01780 (Bankr. S.D.N.Y.),

dated Aug. 10, 2010, http://madofftrustee.com/CourtFilings.aspx. On June 28, 2011, the bankruptcy court granted the Trustee's motion and affirmed its position, as supported by the SEC and SIPC.[64] Mem. Decision and Order, Docket No. 4193, *SIPC v. BMIS*, No. 08-01780 (Bankr. S.D.N.Y.), dated June 28, 2011, http://madofftrustee.com/CourtFilings.aspx.

B. Becker's Participation in the Enforcement Actions Against Madoff-Related Entities

OGC also played a role in consideration of the enforcement actions against Madoff-related entities and individuals. The OIG reviewed certain action memoranda recommending Commission action against such persons and entities, and each action memorandum that we reviewed identifies OGC as a "Division Consulted." Ex. 168. As a general matter, Richard Levine, who was an Assistant General Counsel from approximately 1997 through May 2010, when he was promoted to Associate General Counsel, as well as others within his office, was responsible for reviewing draft action memoranda from the Division of Enforcement to consider the legal sufficiency of what was in the memorandum, the charges being recommended to some extent, and policy issues that were raised in memoranda.[65] Levine Testimony Tr. at 6, 7-8. Becker testified that he "had a minor role" with respect to the Madoff-related enforcement matters, and that he did not recall any significant involvement in the process. Becker Testimony Tr. at 15.

Levine testified that he generally recalled discussing some Madoff-related enforcement matters with Becker while he was General Counsel from 2009 through 2011. Levine Testimony Tr. at 13-14, 17. Specifically, he recalled discussing the Commission's action against a certain investment firm involved in Madoff's activities with Becker regarding how to frame the theories asserted. *Id.* at 16-17. The Staff Attorney and Regional Trial Counsel in the Division of Enforcement in the New York Regional Office who handled the Madoff-related enforcement matters did not recall specific communications with Becker regarding these matters. NYRO Trial Counsel Testimony Tr. at 19-21; NYRO Staff Attorney Testimony Tr. at 10. However, NYRO

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[64] [redacted]

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[65] As a general matter, if an action memorandum was scheduled for consideration at a regularly scheduled Commission meeting, Levine and his colleagues would discuss the proposed enforcement action at a regular OGC meeting held a week prior, and this was the case during Becker's tenure as General Counsel from 2009 through 2011. Levine Testimony Tr. at 9, 11. In other instances, Levine or his colleagues would have to consult with the General Counsel, if at all, on an *ad hoc* basis. *Id.* at 12-14.

Trial Counsel had some recollection of consulting with Becker or gaining an understanding of his position in connection with the action against that same investment firm. NYRO Trial Counsel Testimony Tr. at 21. That recollection is consistent with the contemporaneous documentation, indicating that the matter was discussed at a previous OGC meeting and that the New York Regional Office staff had provided revised language in response to OGC's concern.[66] Ex. 170.

[redacted] The OIG investigation did not identify additional documentary evidence that Levine received input from Becker on other enforcement actions against Madoff-related individuals and entities.

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C. Becker's Participation in the Disciplinary Review of Employees in OIG Madoff Report

Becker also had substantive involvement in the SEC's disciplinary process against employees identified in the OIG's report of investigation into the SEC's handling of the Madoff Ponzi scheme. In August 2009, when the OIG issued its Madoff report, only Chairman Schapiro and David Becker received copies of the entire, unredacted report. Ex. 173. Becker recalled receiving an unredated copy of the report, along with the Chairman, and explained that the personnel who redacted that report also would have received unredacted copies at some point.[67] Becker Testimony Tr. at 12. *See also* Risinger Testimony Tr. at 88-89.

Shortly after the issuance of the OIG's Madoff report, Becker was involved in the decision to hire an independent firm to review the report to consider disciplinary action arising therefrom. Becker Testimony Tr. at 13. Becker testified that he recommended to the Chairman that the SEC hire such a firm because he "wanted to be sure that we did this right" in light of potential scrutiny of any actions taken. *Id.* He also acknowledged that typically, the OGC reviews and participates in making recommendations on disciplinary actions, but in this instance, he wanted to ensure that there was advice from an expert law firm with no stake in the matter. *Id.* Becker also testified that he was involved in the decision to select the firm that was ultimately hired. *Id.* Upon receipt of budget projections from the firm that was ultimately selected, he forwarded the information to Chairman Schapiro, saying: "This is ok financially. Should we sign them up?" Ex. 174. Chairman Schapiro responded that she thought they should. *Id.*

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[66] Contemporaneous documentation also indicated that Becker received a copy of a draft supplemental memorandum regarding the action against the investment firm. *See also* Ex. 169.

[67] Becker also acknowledged that he had a role in redacting the report. Becker Testimony Tr. at 86.

After the independent firm was hired, Becker interacted "[a] bit" with that firm in describing the overall process to them, setting the ground rules, and receiving high-level progress reports. Becker Testimony Tr. at 14. Jeffrey Risinger, former Director of the Office of Human Resources, testified that he attended a meeting with the firm to obtain a summary of its findings, and that Becker also attended that meeting. Risinger Testimony Tr. at 77-78. After that firm submitted its recommendations, Becker was involved in the disciplinary process as it went forward. Becker Testimony Tr. at 14. Becker helped determine what the process should be going forward for the disciplinary matters and ultimately presented that process to the Chairman. *Id.* He also reviewed certain drafts of the initial proposed actions and apparently discussed those drafts with OHR. *Id.*; *see also* Ex. 175. Risinger explained that prior to the ultimate issuance of the proposed actions, there were some concerns about the process to be employed which he recalled discussing with Becker and the Chairman, among others. Risinger Testimony Tr. at 82-83.

After the proposals were made, Becker then advised the Chairman at the next stage of the process.[68] Becker Testimony Tr. at 14. That stage involved oral replies to the Chairman who served as the deciding official.[69] Risinger Testimony Tr. at 84-85. Becker recalled participating in a couple of appeals by employees. Becker Testimony Tr. at 14. Other SEC employees testified that there were two oral replies that certain employees made to the Chairman before Becker's departure from the SEC, and that he participated in those replies.[70] OGC Sr. Counsel #2 Testimony Tr. at 15; Risinger Testimony Tr. at 84; *see also* Ex. 180 ("I understand that David Becker will be conducting these meetings with the Chairman."). Becker testified that he advised the Chairman as to the appropriate disciplinary action "in a preliminary way, in one matter," but that he did not recall whether the other appeals had progressed to that point before his departure. Becker Testimony Tr. at 15. The third and final oral reply occurred near the time that Becker left the Commission and after the initial press coverage of the clawback suit against Becker. OHR Assistant Director Testimony Tr. at 8-9; Ex. 180 (oral reply will be on February 24). Indeed, OHR Assistant Director explained to the OIG that she recalled being told regarding this oral reply that OGC "didn't want to sit in because of David Becker's issue [with respect to his mother's account] and in addition, because they

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[68] Risinger agreed that Becker essentially was the Chairman's principal advisor with respect to the disciplinary actions, and that Becker's role would be to advise the Chairman. Risinger Testimony Tr. at 84, 85. OHR Assistant Director testified that to her knowledge, OGC took the lead in advising the Commission with respect to the Madoff disciplinary process. OHR Assistant Director Testimony Tr. at 9. OHR Assistant Director also explained that she understood that Becker was advising the Chairman regarding what action to take regarding the disciplinary proposals. *Id.* at 10. OGC Sr. Counsel #2 testified that she assumed that Becker was advising the Chairman on the disciplinary decisions, but did not discuss his role with him. OGC Sr. Counsel #2 Testimony Tr. at 20, 37.

[69] Contemporaneous documentation indicates that Becker also provided advice regarding the timing of the decisions and was copied on discussions regarding the process with the Chairman's office. Ex. 176.

[70] In connection with the oral replies, Becker was provided copies of the binders of briefing materials for each of the employees for whom the Chairman had to make a decision. Ex. 177; OGC Sr. Counsel #2 Testimony Tr. at 15, 24. He also received copies of draft executive summaries prepared by OGC and of summaries of the oral reply. Ex. 178; Ex. 179.

would litigate any cases that might result from discipline." OHR Assistant Director Testimony Tr. at 8; *see also id.* at 11.

X. Becker Had No Role in Madoff Examinations or Investigations Prior to His Return to the Commission

The OIG investigation has not identified any evidence that Becker was involved in examinations or investigations of Madoff or BMIS during his first tenure at the SEC prior to Madoff's December 11, 2008 confession. The OIG carefully reviewed Becker's e-mails from his first tenure at the SEC (approximately 58,000 e-mails) to determine whether Becker played any role in any examinations or investigations of Madoff. We also reviewed the e-mails of relevant current and former SEC personnel involved in the investigation and examination process during the period Becker was at the SEC for any references that would indicate any of these individuals ever communicated with Becker. We further reviewed the examination reports of Madoff and BMIS dated January 26, 1996, August 3, 2000, and September 2, 2005, the submissions and communications to the SEC from Harry Markopolos in May 2000, March 2001, October 2005, November 2005, December 2005, and June 2007, and the other exhibits to the OIG's Report of Investigation No. OIG-509 and found no evidence that Becker had any involvement in any of these matters.[71]

In testimony before the OIG in this investigation, Harry Markopolos, a Chartered Financial Analyst and Certified Fraud Examiner, who had made three major submissions about Madoff to various offices within the SEC, along with other contacts, over an eight and a half year period, confirmed that prior to Madoff's confession, he did not communicate with Becker. Markopolos Testimony Tr. at 7-8. Markopolos also stated that he had no reason to believe that Becker played any role in the SEC's lack of sufficient investigation or examination of Madoff to uncover his Ponzi scheme. *Id.* at 8.

Similarly, Becker testified that he was not aware of any of the complaints made by Markopolos (or anyone else) during his first tenure as General Counsel. Becker Testimony Tr. at 11-12. He also testified that he had not had any communications with Markopolos regarding Madoff during his first tenure as General Counsel. *Id.* at 12. Becker further stated that he had never met or communicated with Madoff and explained that he knew of Madoff during his first tenure as General Counsel only as part of a discussion about certain firms that paid for order flow. *Id.* at 86. Becker testified that when Madoff confessed, his "first reaction was astonishment that this had . . . gone on for so long." *Id.*

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[71] More generally, in its investigation into the SEC's failure to uncover Madoff's Ponzi scheme, the OIG did not find evidence that information relating to the examinations and investigations were raised in OGC in Washington, D.C., nor did it find that the two investigations and three examinations of BMIS that the SEC conducted were performed by OGC or that OGC played any role in or influenced those examinations and investigations. *See generally* Report No. OIG-509 at 27-42, http://www.sec.gov/news/studies/2009/oig-509.pdf.

XI. The SEC Ethics Office Provided Contemporaneous Advice to Becker Regarding His Interest in His Mother's Estate's Madoff Account

As discussed in detail below, Becker sought and obtained ethics advice regarding his mother's estate's Madoff account on two occasions: (1) around the time he rejoined the Commission in Febraury 2009 and (2) upon receipt of the letter from the law firms representing Madoff customers in May 2009.

A. Lenox, as Ethics Counsel, Reported Directly to Becker, the General Counsel

Becker, as the General Counsel, was the Commission's chief legal officer. 17 C.F.R. § 200.21(a). He was responsible for, among other things, administering the Commission's Ethics Program. *Id.* During his second tenure at the SEC, Becker also served as the alternate Designated Agency Ethics Official ("DAEO").[72] Becker Testimony Tr. at 16; Lenox Testimony Tr. at 27. Lenox was appointed as the Commission's Ethics Counsel and Designated Agency Ethics Official on April 26, 2004. SEC Release No. 2004-57, *William Lenox Named Ethics Counsel* (April 26, 2004), http://sec.gov/news/press/2004-57.htm; Lenox Testimony Tr. at 20-21. Lenox served in that role until July 2010 when he resigned from that position [redacted].[73] Lenox Testimony Tr. at 21.

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The Ethics Counsel is part of the Office of the General Counsel. 17 C.F.R. § 200.21a(a); Lenox Testimony Tr. at 23. The responsibilities of the Ethics Counsel include, among other things, providing advice, counseling, interpretations, and opinions with respect to the regulations governing the conduct of members and employees and former members and employees of the Commission, the SEC's canons of ethics, and the Standards of Conduct. 17 C.F.R. § 200.21a(a)(6). Lenox testified that the SEC's Ethics Counsel also dealt with issues of professional responsibility and the Commission's own conduct regulation. Lenox Testimony Tr. at 23.

In 2009, Lenox, as Ethics Counsel, and the Ethics Office reported to Becker. Lenox Testimony Tr. at 23; Becker Testimony Tr. at 17. Chairman Schapiro was aware that the Ethics Office reported to Becker. Schapiro Testimony Tr. at 67. As his direct supervisor, on December 2, 2009, just seven months after Lenox provided advice regarding Becker's participation in the Madoff Liquidation,[74] Becker conducted a performance evaluation for Lenox. Lenox Testimony Tr. at 23; Ex. 181; *see also* Becker Testimony Tr. at 17 (while Becker did not recall doing the evaluation, the fact of doing

[72] The responsibilities of a DAEO are set forth at 5 C.F.R. § 2638.203(a) and discussed further below.

[73] Lenox later returned to the Commission as professional responsibility counsel in September 2010 and served in that capacity until he retired on June 30, 2011. Lenox Testimony Tr. at 21. Becker testified that it "was [his] decision" to bring Lenox back in the professional responsibility role. Becker Testimony Tr. at 22.

[74] *See* Section XI.D *infra*.

an evaluation "doesn't surprise" him). In his evaluation, Becker wrote: "The performance of the ethics office has been superb. . . . The quality of the ethics advice is very high. It shows expertise and nuance, both from the standpoint of technical understanding and from the standpoint of apprehending the risks to the agency even where legal requirements are carefully followed."[75] Ex. 181 (responses to objectives 2 and 3). The duties of the Ethics Counsel and the DAEO are similar. Lenox Testimony Tr. at 23. The DAEO is responsible for coordinating and managing the agency's ethics program. 5 C.F.R. § 2638.203(a); Lenox Testimony Tr. at 23 ("The DAEO has responsibility for the government-wide implementation of the ethics program."). The DAEO is appointed by the Chairman, and Lenox understood that he reported directly to the Chairman in that role and so advised Becker.[76] 5 C.F.R. § 2638.201 and 202(b); Lenox Testimony Tr. at 22-23; Becker Testimony Tr. at 17-18.

B. As Ethics Counsel, Lenox Emphasized His Role As A Resource and Was Reluctant to Keep Written Records of Advice

Lenox explained his belief that as Ethics Counsel, the most important thing was that people trust him, and that people trusted him with "incredibly personal information." Lenox Testimony Tr. at 43. His approach was to make "a conscious decision that [he was] going to assume that you are telling [him] the truth" but also to "ask probing questions" to determine what actually was at issue and to verify things. *Id.* at 48-49. Lenox explained that he viewed his job as "to create a culture where people would seek advice, and to alert those employees – all employees – where the danger lines were, and to encourage them to come and seek ethics advice, because that provides a level of protection." *Id.* at 98-99. He further stated, "Nobody had to bring anything to my attention. . . . [T]here is no requirement to seek ethics guidance. I am a resource. I wanted people to do that, because I could offer them a certain amount of experience with the rules and regulations, knowledge of what we had decided in similar cases." *Id.* at 81.

Both Lenox and Becker testified that Lenox's ethics advice was not binding as a matter of law, but that as a practical matter, it generally would not be prudent to ignore such advice. Becker Testimony Tr. at 44; Lenox Testimony Tr. at 81-82. *See also* 5 C.F.R. § 2635.107. In addition, Lenox stated that "[n]obody has to bring anything to [his] attention," but Lenox also explained that with respect to appearance concerns, "it is also in your interest to seek [ethics advice], because if an ethics official tells you it's okay, and someone second-guesses you down the line, it is the ethics official whose

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[75] Becker testified that Lenox's ethics advice was "very good. Sometimes a little conservative, but very good. Very thoughtful and went beyond, sometimes, the letter of the rule." Becker Testimony Tr. at 18-19. In terms of Lenox's advice being a little conservative, Becker clarified that there were times when his and Lenox's interpretation of the applicable rules differed, and "[w]e did it his way." *Id.* at 19.

[76] However, when there was an attempt made to find documentation to confirm that Lenox, as DAEO, reported to the Chairman, the staff was unable to find any documentation to support that position. Martens Testimony Tr. at 33-34. Moreover, no one was able to explain how practically Lenox was reporting to two different people for the same duties.

judgment is to be second-guessed, not yours, and you are absolutely protected."[77] Lenox Testimony Tr. at 81, 100.

On appearance issues, Lenox testified as follows:

> The people who, in the ethics community, that I respect the least are the ones who always say no. If you are a constant naysayer, one, nobody comes to secure advice; two, you're not actually doing your job. There are appearance problems that can, after the fact, be found in any decision that an ethics official makes. The key, as I saw it in my job as DAEO and as ethics counsel, was to make decisions. That's the reason that I was promoted. I was willing to make decisions. That requires a certain amount of willingness to be second-guessed by other people. If you always say no, you will never be second-guessed. That was not what I saw my role to be.

Lenox Testimony Tr. at 76. He further testified, "The question of is there an appearance problem is: What does a reasonable person, with knowledge of all the facts, consider? By default, I was the Commission's reasonable person."[78] *Id.* at 77.

Because of the sensitive nature of what people disclosed to him, Lenox "was reluctant, generally, to keep written records of [his advice]. . . . And [he] basically told employees, 'If you want a record of my advice, you write me an email, or you put it in writing, and I will confirm that. . . .'" Lenox Testimony Tr. at 43. Lenox testified that "it was not [his] practice to keep those kinds of notes." *Id.* One current Assistant Ethics Counsel who worked for both Lenox and the current Ethics Counsel indicated that "everybody is supposed to memorialize or document" the advice they give, that Lenox "wanted people to do it," but that the current Ethics Counsel, Shira Minton,[79] is "probably more adamant about it." Assistant Ethics Counsel #1 Testimony Tr. at 15. According to this Assistant Ethics Counsel, documentation could be done in a number of ways, including e-mail, a formal written memorandum, or a checklist. *Id.* Another current Assistant Ethics Counsel who joined the Commission after Lenox resigned explained that it was her sense that there is now more of an effort to document or

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[77] In fact, when questions arose in February 2011 concerning Becker's participation in the Madoff Liquidation, Lenox e-mailed Becker: "Please just blame me; you did what you were supposed to do." Ex. 182.

[78] Lenox, as the "Commission's reasonable person," held Becker in extremely high regard. He testified that he had "[g]reat professional respect" for Becker and "an appreciation for his humor and his abilities as a lawyer." Lenox Testimony Tr. at 27. He further described Becker as a "great man and a great lawyer." *Id.*

[79] Minton joined the agency in August 2010 as Ethics Counsel after Lenox's resignation as Ethics Counsel. SEC Press Release No. 2010-142, *Shira Pavis Minton Named SEC Ethics Counsel* (Aug. 5, 2010), http://www.sec.gov/news/press/2010/2010-142.htm

memorialize advice given, as opposed to previously, because that is the current Ethics Counsel's view as to what is appropriate. Assistant Ethics Counsel #2 Testimony Tr. at 9.

C. Becker and Lenox Discussed Becker's Mother's Estate's Account Around the Time Becker Returned to the Commission

Around the time that he returned to the Commission in February 2009, Becker discussed his mother's estate's BMIS account with Lenox. This discussion occurred as part of an in-person meeting, and the OIG investigation has not identified any written record of that meeting. Becker Testimony Tr. at 27-28 31; Lenox Testimony Tr. at 43-44. Lenox testified that sometime shortly before Becker's return to the SEC in February 2009, he ran into Becker in the SEC's Station Place building, at which time Becker told Lenox that he was returning to the SEC as General Counsel. Lenox Testimony Tr. at 29. Lenox recalled that he told Becker that, as with any senior officer joining the Commission, there would be ethics issues to address and also noted that he ran the Ethics Office somewhat differently than his predecessor and suggested they have a discussion. *Id.* According to Lenox, as Becker indicated he was free at that time, Becker and Lenox went to Lenox's office to discuss a number of issues.[80] *Id.* at 29-30.

During that meeting, Becker and Lenox discussed a variety of issues, including potential conflicts of interest.[81] Becker Testimony Tr. at 27, 31-32; Lenox Testimony Tr. at 31-34. Lenox explained to Becker that under certain OGE regulations, he "would have a certain black-out period on . . . particular matters involving specific parties" regarding his former clients and law firm for the first year he was at the Commission. Lenox Testimony Tr. at 32-33. Lenox testified that they also discussed Becker's financial holdings at some point when Assistant Ethics Counsel #3 was present, and Lenox recalled that Becker actually gave the Ethics Office access to his accounts, in order to allow them to create the lists that would be used to perform his conflict checks. *Id.* at 33.

Both Lenox and Becker also recalled discussion of Becker's mother's estate's Madoff account near the time of Becker's return to the Commission.[82] Both recalled that

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[80] Becker did not recall specifically how the meeting came about, but recalled that a meeting occurred. Becker Testimony Tr. at 23-24, 27. He believed that the meeting was in Lenox's office. *Id.* at 28. Becker did not recall whether his meeting with Lenox took place before or after he started back at the SEC, but said it occurred around the time he started. *Id.* at 27. *But see id.* at 23 (indicating that Becker thought it occurred before he started work).

[81] At some point, Lenox invited Assistant Ethics Counsel #3 to join the meeting. Lenox Testimony Tr. at 30-31. Assistant Ethics Counsel #3 recalled meeting with Becker when he returned to the Commission once in Becker's office and once in Lenox's office and that Becker discussed a number of situations that could give rise to potential conflicts of interest. Assistant Ethics Counsel #3 Testimony Tr. at 10.

[82] Both Becker's and Lenox's testimony was consistent with their descriptions of this conversation provided in responding to, or in the process of responding to, Congressional inquiries in February and March 2011. Ex. 61; Ex. 183. Assistant Ethics Counsel #3 recalled Becker mentioning his mother's estate's Madoff account in a meeting that occurred in Lenox's office before Becker's return to the SEC, but did not have a specific recollection of that discussion. Assistant Ethics Counsel #3 Testimony Tr. at 10-11.

Becker told Lenox that his mother had an account with Madoff, that she had died, and that these funds were liquidated as part of her estate. Becker Testimony Tr. at 28; Lenox Testimony Tr. at 34. Becker also recalled that he had told Lenox that the funds from the liquidation were used to pay estate taxes. Becker Testimony Tr. at 28. Lenox further recalled that Becker indicated that he had no present connection with any Madoff account. Lenox Testimony Tr. at 34. Lenox did not specifically recall Becker telling him whether his mother's estate's account had gained or lost money, that he was a beneficiary or executor of his mother's estate, or that he might be subject to a clawback suit. *Id.* at 39-40. Lenox noted that the Madoff account was one item raised among "a number of matters that were preliminary to his coming back," and testified it would surprise him if Becker had mentioned the possibility of a clawback suit during that discussion. *Id.* at 40.

Around the time of this initial conversation with Lenox, which was approximately when Becker learned of the existence of his mother's estate's BMIS account, Becker "understood that in bankruptcy, there is a possibility of . . . a trustee clawing back certain proceeds," but he did not know the "statute of limitations, the degree of fault that had to be shown, whether it made a difference here that whatever amounts [he] got came not from Madoff, but from [his] mother's estate, a separate legal person." Becker Testimony Tr. at 29. Becker added, "So at the highest level of generality, I understood there was the possibility of clawback actions." *Id.* At that point, Becker made an inquiry "to a limited extent" to determine the likelihood of such a clawback suit by asking a partner at his then-law firm what the possibility was, and the colleague said that it seemed unlikely, but that it was very preliminary and hard to know. *Id.* at 30. Becker did not do any additional investigation. *Id.*

Lenox noted that at the time of the conversation, Becker was not yet General Counsel, and that Lenox was not giving advice or doing the matter-specific review that he would do as specific matters arose. Lenox Testimony Tr. at 34-35. He concluded generally that the issue:

> doesn't raise any red flags for me at the moment that what I understood the Commission to be doing was investigating whether Mr. Madoff had minions who . . . were also potentially guilty of fraud. . . . [A]lthough we would obviously, as I explained, do our more particularized checks later on, that the mere fact that his mother had been a Madoff investor did not strike me as being disabling on that. . . . I did not see the fact that his mother had once had a Madoff account would preclude him from reviewing any recommendations or implementing any changes in the way the Commission operated.

Assistant Ethics Counsel #3 did not recall that either Lenox or he said anything specific to Becker about the account. *Id.* at 11-12.

Id. at 35; *see also* Becker Testimony Tr. at 31 ("Lenox's "reaction was, 'Well, we'll have to take it on a case by case basis,'" and "it didn't strike him as enough – something that would [cause] my recusal from anything that touched upon the Madoff matter and . . . we would consider it as matters arose.").

Lenox did not do any specific investigation to determine on what Madoff matters Becker might work. When asked how he determined what those matters would be, Lenox stated that the ongoing Inspector General investigation was widely known, and he was counseling potential subjects of that investigation. Lenox Testimony Tr. at 38. In addition, he "worked very closely with the operating divisions, just as part of [his] job" and "[knew], as a general matter, a lot of the big things that were happening in the agency," although he did not receive reports of the investigation or talk to people on the team. *Id.* He did not state that he did any additional investigation into this issue. In response to a question as to whether he made any effort to determine the scope of Madoff-related matters on which Becker might work, Lenox responded that that the meeting was "not a determination, . . . not an investigation, . . . and not an actual advice" as to which matters in at Becker could do. *Id.* at 38-39. When asked if he knew at the time of this initial meeting that the SEC was going to be involved in the Madoff Liquidation and issues related to SIPA, Lenox stated that he did not know at the time of his testimony what he knew in February or late January of 2009. *Id.* at 40. However, his description of the Enforcement and OIG matters of which he was aware indicated that he did not consider the possibility of the SIPA-related proceedings at that time.[83]

Lenox further testified that, during his initial conversation with Becker, he also considered appearance issues and determined that he did not see any issues at that point. Lenox Testimony Tr. at 37. Becker did not recall if Lenox mentioned a potential appearance issue during that conversation. Becker Testimony Tr. at 32.

D. Becker Sought Ethics Advice from Lenox in May 2009 Regarding His Work on the Madoff Liquidation

As discussed in Section IV.A *supra*, in early May 2009, Becker received the May 1 Letter advocating the Last Account Statement Method. Becker explained to the OIG that soon after receiving and reviewing the May 1 Letter, he consulted with Lenox as to whether he should participate in the issue raised by the letter. Becker Testimony Tr. at 40-41. Becker testified:

> I have some experience practicing law and some experience with ethics issues. And I believe very strongly that nobody is the best judge of their own conduct and what to do of their own conduct. I've seen people make dreadful errors

[83] *See also* Ex. 183 ("At that time, to my recollection, the Commission was investigating the operations of the Madoff firm. I concluded that no such investigation into possible wrong-doing by Madoff or others would affect a long-closed account held by Mr. Becker's mother.").

> doing that. And when I have trained other people on professional issues, including ethics issues, I have said, "The most important thing to do is to consult, consult, consult."

Id. at 43-44. Accordingly, he sought guidance from Lenox because this involved his own participation in a matter. *Id.* at 44. He also testified that if Lenox had told him not to participate, he would not have done so, particularly because of the public's pejorative view of the SEC with respect to Madoff. *Id.* at 45-46.

Neither Becker nor Lenox recalled a specific conversation at the time of the May 1 Letter, but both believed that some conversation likely occurred in advance of their e-mail exchange. Becker Testimony Tr. at 42; Lenox Testimony Tr. at 46-47. Thereafter, Becker sent an e-mail to Lenox asking whether he could participate in the subject of the May 1 Letter. Ex. 184. The e-mail indicated that "a number of law firms [were] asking that the Commission instruct the Madoff Trustee to change his interpretation of SIPA as it relates to the meaning of 'securities positions' as to which customers may file a claim." *Id.* The e-mail continued:

> As I mentioned to you when I first started, I inherited some money from my mother's estate that included the proceeds of an account held with Madoff securities. My mother died in June 2004, and her estate was liquidated in in [*sic*] 2006 or 2007. The Madoff account was opened by my father for my mother some time before his death in January 2000. I don't know how much money was invested; the amount withdrawn was somewhere in the neighborhood of $2 million. I'm told that the account was liquidated and the proceeds used to pay estate taxes.
>
> The Madoff Trustee has instituted a small number of lawsuits to "claw back" sums that were distributed to by [*sic*] Madoff to customers. For example, press reports over the weekend state that the Trustee filed a lawsuit last week seeking $1 billion from Stanley Chais, alleging that the returns he and his customers received were so obviously inflated that he must have known that they could not have been achieved lawfully. In theory, the Trustee could file such a suit against everyone who received distributions from his or her Madoff account. I have no idea whether any such lawsuit could be brought against me based on distributions from my mother's estate. I don't know the likelihood of any such lawsuit. Among other things –

- The amounts involved are relatively small (when compared to the $50-65 billion size of the Madoff scheme), so that litigation might not be cost effective;
- The amounts involved came to me as a beneficiary of my mother's estate and not from my own account;
- I had no involvement with the administration of any investments in my mother's estate;
- To the extent my mother had a Madoff account, she almost certainly wasn't aware of any wrongdoing (she was a social worker and an academic); and
- The proceeds from the account were used to pay estate taxes.

The issue raised in the letter received today concerns the scope of SIPA coverage, not anything related to the liability of third parties. It strikes me, though, that it is theoretically conceivable that to the extent SIPA coverage is more broadly available than the Trustee has stated, that might make it less likely that the Trustee would bring claw back actions against persons at the margin. My instinct is that any claim against me would be much too small and of dubious merit to bring in any event, but I can't say that I'm certain.

Let me know, please, what I should do.

Id. Becker did not recall Lenox asking for additional facts or directing him to seek additional guidance if new facts arise. Becker Testimony Tr. at 46. He also did not recall any new facts arising. *Id.* at 46-47.

Lenox responded to Becker's query via e-mail about 25 minutes later, stating:[84]

The small size of the distribution, or the way in which you obtained a portion, are not relevant to whether you may participate (similar to the other matter we discussed last

[84] Lenox testified that he would have asked Assistant Ethics Counsel #3 to weigh in before responding to Becker. Lenox Testimony Tr. at 48. In fact, before he responded, Lenox forwarded Becker's e-mail to Assistant Ethics Counsel #3 and asked "Your thoughts?" Ex. 185. It does not appear that Assistant Ethics Counsel #3 responded via e-mail, and he testified that he did not have a specific recollection of his role in Lenox's consideration of the issue, though he assumed that he did participate in Lenox's decision-making process. Assistant Ethics Counsel #3 Testimony Tr. at 13. Assistant Ethics Counsel #3 also did not recall what his advice was, what his recommendations were, or whether he concurred with Lenox's advice. *Id.* at 13-14.

> week). The question is whether the matter in which you are asked to participate will have a direct and predictable effect on your financial interest, however small. In this case you are being asked to participate in a question about a specific interpretation of SIPA. As you note, this is a legal question distinct from any decision of the trustee to decide from whom to seek to "claw back." There is no direct and predictable effect between the resolution of the meaning of "securities positions" and the trustee's claw back decision. For this reason, you do not have a financial conflict of interest and you may participate.

Ex. 184. Lenox did not have a specific recollection of the steps he took when considering whether Becker could participate. Lenox Testimony Tr. at 49. However, based on the way he generally handled such questions, Lenox believed that he would have asked Assistant Ethics Counsel #3 to verify that Becker's former firm was not one of the law firms involved because Becker had a covered relationship with that firm at that point in May 2009. *Id.* at 49-50. He also believed that he would have asked Assistant Ethics Counsel #3 or possibly another Assistant Ethics Counsel to verify "that the decision to bring a clawback action in a SIPC bankruptcy was the exclusive decision of the trustee, and that the Commission did not tell the trustee who to claw back or whom not to claw back." *Id.* at 50.

1. Lenox's Analysis Focused on Incorrect Understandings Regarding the SEC's Role in the Madoff

In his testimony, Lenox described the issue he considered as "if it would be appropriate for [Becker] to participate in an amicus review of the meaning of securities position within the meaning of [SIPA]."[85] Lenox Testimony Tr. at 41. He further stated that "it's not the first time that questions under an *amicus* program had come up." *Id.* at 51. Lenox described the amicus program as meaning:

> [T]he Commission and the Office of General Counsel goes [*sic*] to the Commission when there is a question about the meaning of the securities laws, and that the Commission is entitled to weigh in on what the meaning of the securities

[85] Lenox did not have a recollection of what the term "securities position" meant. Lenox Testimony Tr. at 62. Lenox testified that he "[couldn't] really tell" the OIG whether he understood in May 2009 that the issue raised by the May 1 Letter related to the differing approaches presented by those espousing the Last Account Statement Method and the Money In/Money Out Method. Lenox Testimony Tr. at 84. He also said that it was difficult for him to say at the time of his testimony exactly what he knew in May 2009 with respect to the issue that the SEC was considering. *Id.* at 51.

> laws are. When the Commission acts as the Commission, it is entitled to -- *Chevron*[86] . . . deference.
>
> When it goes before a court, it's entitled to the deference of the persuasiveness of the arguments that it's making. And that it is important for the Commission to decide when and when not to weigh in with courts on what the meaning of the securities laws are, that absent a real reason, that it's important for the highest-level officials to be part of that decision. . . .

Id. at 80. Lenox also stated that the particular securities law question involved could have come up in any case where there was a Ponzi scheme, such as Stanford, but that here, it happened to come up in a Madoff-connected matter. *Id.* at 68-69. However, Lenox later acknowledged that the Commission had a role in SIPC bankruptcies and appeared to acknowledge that the Commission was a party to the Madoff Liquidation. *Id.* at 112.

Lenox's focus upon the *amicus* participation of the Commission ignored the fact that, under SIPA, the SEC is a party to all liquidation proceedings. SIPA provides, "The Commission may, on its own motion, file notice of its appearance in any proceeding under this chapter and may thereafter participate as a party." 15 U.S.C. § 78eee(c). Indeed, in its appellate brief in the Madoff Liquidation, the SEC expressly stated: "The Commission is submitting this brief as *amicus curiae* in accordance with the procedures of the ECF filing system. Under Section 5(c) of SIPA, however, the Commission may 'file notice of its appearance in any proceeding under the Act and may thereafter participate as a party.'" Ex. 186. Consistent with that role as a party, Becker, in contrast to Lenox, did not view the SEC's participation in the net equity issue in the Madoff Liquidation as a theoretical issue. Becker Testimony Tr. at 59. He agreed that it was his understanding that if SIPC disagreed, the SEC should eventually recommend that the court adopt the SEC's position, not SIPC's position, and indicated that "[t]he Commission had done that in the past and may do it again." *Id.*

Lenox testified that the trustee's independence in bringing clawback suits was an important part of his decision. Lenox Testimony Tr. at 63. He further explained to the OIG that "the decision on clawbacks . . . is the trustee's decision, which removes the possibility of the general counsel and senior policy advisor weighing in on what the meaning of a general applicability securities law section is does not violate the financial conflict of interest statute." *Id.* Lenox stated that he was focused on whether there was a direct and predictable effect on Becker's financial interest, and there was none "because you had this intervening actor who made an independent decision on whom or whom not to bring a clawback action against." *Id.* at 54. Lenox's analysis did not appear to

[86] Under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), courts generally defer to an agency's interpretation of the statute it is charged with implementing.

consider that the clawback suits were part of the overall bankruptcy proceeding or that they are brought by the same trustee with whom Becker would be negotiating on behalf of the Commission. Lenox's analysis also did not appear to have considered whether there was any relationship between the issue referenced in Becker's e-mail and increasing the scope of SIPA coverage, which could affect the need for and amount of clawback suits.[87]

2. Becker Incorrectly Assumed Clawback Suits Applied only In Cases Involving Wrongdoing and Accounts Over $2 Million

Becker testified to the OIG that he did not "really know what [Lenox's] analysis was" or what Lenox did or considered to reach his conclusion. Becker Testimony Tr. at 45. However, Becker's own view was that his participation was appropriate under the criminal statutes and implementing regulations and as a prudential matter. *Id.* at 47. He explained his reasoning, which first looked to what he knew at the time of his February 2009 conversation with Lenox.[88] *Id.* at 47-48. Becker noted, as part of his analysis, that the account "never touched [him] in any way" and "had no misbehavior associated with it in any way." *Id.* at 48. Accordingly, Becker "assumed, evidently not correctly, that all those facts . . . made it less likely that there would be a clawback action." *Id.* Moreover, because the few clawback actions instituted at that point involved billions of dollars and the size of the fraud was about $65 billion, it "struck" Becker "as a bang [for] the buck standpoint, [that] it's quite possible the trustee was not going to get around to recreating records, [much] less bringing cases for claims that involved something significantly less than $2 million." *Id.* at 48-49.

Both SIPC and the Trustee told the OIG that it would be unreasonable to conclude that a clawback suit was unlikely in light of the facts of Becker's mother's estate's account. The Trustee explained that a person who had withdrawn approximately $1.5 million in fictitious profits would "generally speaking" be subject to a clawback suit. Picard Interview Tr. at 14-15. SIPC President Harbeck told the OIG that in the Madoff

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[87] When asked whether his analysis would change once Becker had been sued in a clawback action, Lenox responded that he was not Ethics Counsel at that time and that the analysis would be based on "a different set of circumstances." Lenox Tr. at 100-01. He did not state definitively that there would be a conflict of interest or an appearance of impartiality, although he did state that there would be a covered relationship and that the "assumption or the inclination . . . is that a reasonable person would question the impartiality." *Id.*

[88] Becker's testimony regarding what he knew in February 2009 was consistent with the facts set forth in his May 4, 2009 e-mail to Lenox. *See* Ex. 184. He testified, "What I knew was that my mother had an account at Madoff, that she didn't make the investment decision. She didn't make investment decisions. My father died in 2000. So the account must have been opened sometimes before 2000. And there is no way on God's green earth that my father, who was probably the most consciously ethical person I've ever met, still to this day, had been involved in anything that he knew to be improper. I knew that -- other than that, I didn't know very much. I knew that, to repeat myself, after my mother died, the account was retitled in the name of the estate and that sometime later, my brother, who was doing all the financial affairs of the estate, liquidated the account, had the account transferred, actually, to another brokerage firm and then liquidated it in order to pay estate taxes." Becker Testimony Tr. at 47-48.

Liquidation, "without question . . . a million dollars [in fictitious profits] is an amount that was never contemplated that the trustee would not seek to recover." Harbeck Interview Tr. at 36. He also stated that he did not believe it is a reasonable assumption to think that some amount over $1 million in fictitious profits would be so low that there would be little or no chance of a clawback action. *Id.* at 36. Similarly, Wang stated that, in her personal opinion, the "sum" in Becker's mother's estate's account was large enough that it is at least reasonable to believe that there was a possibility, if not a likelihood, of a clawback action. Wang Interview Tr. at 15-16.

Indeed, SEC personnel testified that there were discussions with SIPC at the early stages of the Madoff Liquidation regarding a dollar threshold to apply in the determination of whether to bring a clawback suit, and that a threshold, likely in the range of $100,000, was discussed. Macchiaroli explained that there were discussions with SIPC regarding who the Trustee would pursue in clawback actions as follows:

> We didn't want to pursue any amounts that were relatively small, say under a hundred thousand or something of that sort. And we didn't want to pursue anything which would involve a clawback of principal. That is, if all they got back was the money they invested, we wanted them to be -- nothing happened, that they would claw back only those which are excessive profits at the most. So that was -- so we were sympathetic to the smaller people.
>
> Q. Right. And so in terms of the smaller amount was their understanding also that 100,000 might be a good threshold?
>
> A I think so. I don't recall, but I think that was what generally people thought. And it could be more depending on the hardship and what -- they actually developed a hardship program. Again, I don't remember the timelines.
>
> Q. But setting aside the hardship program for a minute, if folks were in the millions, $2 million for example of money that could be clawed back, that was not considered by the SEC and SIPC to be too de minimis?
>
> A. I don't think so. I mean we didn't -- we wouldn't have thought that.

Macchiaroli Testimony Tr. at 32-33. Sr. TM Official explained that with respect to clawbacks:

> A. . . . There was a cap. Just the cost of going after it was greater than the money that you would collect. So there

was a -- my recollection [is] there was a cap. Whether it was a hundred thousand or not, I can't recall specifically, but we discussed a cap.

Q. But do you recall generally that it was about that amount of money?

A. That sounds right.

* * *

Q. But you recall that it was, if not a hundred thousand, generally in the hundred thousand dollar range. It wasn't in the million range?

A. That's right. That's right. There is still the hardship exception that was in addition, but this was an attempt to try to have some clarity about how that would be applied.

Q. Okay. And that was something that was discussed among the TM and GC as well?

A. Yes.

Sr. TM Official Testimony Tr. at 29-30.[89]

Moreover, Becker did not do any due diligence to determine whether any of these factors that he listed in his own May 4, 2009 e-mail or mentioned during his testimony would figure into the Trustee's analysis. *See* Becker Testimony Tr. at 48, 92. In fact, he testified that he did not even know if the estate tax issue he referenced in his e-mail to Lenox was relevant and further stated that, with respect to that e-mail, "I wanted to put everything that I knew in front of him. I was not sure whether it would make a difference, in terms of any liability that I or my brothers might have" that those particular funds never went to any of them. *Id.* at 86-87. However, both the Trustee and SIPC explained to the OIG that the factors listed by Becker as weighing against the likelihood of any clawback suit against him were not ones that the Trustee would consider in determining whether to bring a clawback suit. Picard stated as follows:

Q. When there is consideration of whether to bring a clawback suit, does the fact that the individual was aware of the wrongdoing, is that a factor in determining whether to bring a clawback suit?

A. Not necessarily.

[89] Becker testified that he was not aware, at the time, of any threshold below which the Trustee would not bring clawback suits, such as $100,000. Becker Testimony Tr. at 68-69.

> Q. What about in the consideration of whether to bring a clawback suit? Would whether the proceeds were used to pay estate taxes, would that be factor [*sic*] in whether a clawback suit was brought?
>
> A. No.
>
> Q. In terms of consideration of whether to bring a clawback suit, would there be a factor of whether the proceeds went to a beneficiary of an estate, as opposed to a personal account?
>
> A. No; I don't think so.
>
> Q. If it was an estate that was being subject to a clawback suit, would the fact that an individual who was the beneficiary did not participate in the administration of the estate's investments, would that be a factor in whether to bring a clawback suit?
>
> A. No.

Picard Interview Tr. at 13-14. Harbeck agreed that these factors did not weigh into the Trustee's analysis. *See generally* Harbeck Interview Mem. at 2-3. He explained that the fact that an individual investor was not aware of Madoff's wrongdoing was "[a]bsolutely not" determinative as to whether to bring a clawback suit. *Id.* at 2.

Becker testified that he also considered the nature of the legal issue involved, which concerned the "requirement that [SIPC] advanced monies to investors who asserted that they had claims based on this so-called last statement method" and was "not about clawback." Becker Testimony Tr. at 49. Becker explained, "[I]t's not at all clear to me that whatever the courts ultimately do with the SIPA advance issue that that will have any impact on how you measure account values for clawback purposes," and noted, "Different statute, different words, different policy." *Id.* Becker further explained that net equity is a term that appears only in SIPA, but that clawback actions arise under the bankruptcy code which, in turn, references state law fraudulent conveyance statutes. *Id.* at 66. He explained that the purposes of SIPA and clawback liability under bankruptcy law are separate and different issues. *Id.* However, this analysis ignores the fact that SIPA expressly provides that a SIPA trustee, like the Trustee in the Madoff Liquidation, has the same powers as a bankruptcy trustee to bring clawback actions. 15 U.S.C. §§ 78fff-1(a) and 78fff-2(c)(3).

3. Neither Becker Nor Lenox Believed There Was Any Appearance of a Conflict

Becker indicated that "[a]ppearance is . . . a term of art" and a defined term under the regulations. Becker Testimony Tr. at 50. He stated that the analysis is "whether a reasonable person in possession of the facts would doubt one's impartiality." *Id.* In Becker's view, the appearance analysis was "essentially the same" as the conflict analysis, but "with a somewhat lower threshold." *Id.* He added, "To me, the analysis is so clear that . . . I don't think this gives rise to an appearance in any legal sense." *Id.* Becker testified that he also considered a "prudential sense," which, based on his description, was similar to an appearance analysis. *Id.* When discussing this prudential sense, he noted that people refer to "the *New York Times* test" and described it as follows, "[Y]ou do something that, on balance, . . . because something becomes a matter of public attention, critical public attention whether informed or not, whether that is outweighed by the good." *Id.* at 50-51. Becker testified that he was comfortable that he behaved appropriately, stating: "What I think people are not aware of . . . is the extent to which my involvement was useful to the Commission at arriving at an outcome that serves investors and that vindicates the rule of law."[90] *Id.* at 51.

Lenox testified that he "always considered whether there was an appearance issue" when providing ethics advice, and that it was "part of every decision that [he] made," including his February and May 2009 advice to Becker, although his opinion on this issue as it related to his consideration of Becker's mother's estate's account was not reflected in any document or communication. Lenox Testimony Tr. at 36-37, 75. As Ethics Counsel, Lenox made efforts to inform SEC employees of the importance of considering appearances in ethics questions, including a February 2010 Ethics NewsGram to SEC employees entitled "Appearances Matter." Ex. 187. Lenox testified that he edited this document which went out under his direction, and that it reflected his views. Lenox Testimony Tr. at 109. The NewsGram stated that a thorough analysis of an ethics question required at least two steps, including "What possible appearance of impropriety might be raised by engaging in the proposed conduct?" Ex. 187. The memorandum then described the second step as follows:

> In other words: How would it look? What are the optics of the situation; what is the context of the facts and circumstances? Would it pass what has often been referred to as the *New York Times* or *Washington Post* test? If what you propose doing becomes the subject of an article in the press, would you not care or would it look like you were doing something wrong? Even if you wouldn't care, what

[90] Lenox testified that he considered similar concerns in his appearance analysis, noting, "[O]n balance, you would say the reasonable person wants the smartest people, and not necessarily David [Becker], as an individual, but it is a fact that he was a reputed securities lawyer who was making a decision to come back and serve the public and protect investors, and he was here to do this sort of analysis. . . . But that is part of the decision of whether the appearance of impropriety outweighs the public good." Lenox Testimony Tr. at 77-78.

effect would the story have on the SEC and your fellow employees?

Id. Lenox testified that he considered this *New York Times/Washington Post* test when providing his advice to Becker and stands by his conclusion that Becker's involvement in the SEC determinations in the Madoff Liquidation passed this appearance test. Lenox Testimony Tr. at 109-11. He then stated: "I always considered these tests. And I handled what I considered to be the most difficult questions. And somebody had to make the decisions. I was entrusted with that responsibility. I did it. I don't see that I was wrong."[91] *Id.* at 110.

E. The Ethics Office, and Becker, Considered His Recusal from Other Matters Differently Than in the Madoff Liquidation

The OIG investigation found that in certain other similar matters, the Ethics Office considered Becker's participation differently than it did in the Madoff Liquidation. Most notably, for example, in March 2009, shortly after he returned to the Commission, Lenox advised Becker that, based upon additional information now available to the Ethics Office, he should recuse himself from the Commission's consideration of an insider trading matter involving Public Company A. Ex. 188. The basis for that recommendation was that Becker held about $90,000 in securities of issuers that were harmed by the trading at issue in the case, and the Ethics Office concluded: "Even though the staff has not put the issue of a Fair Fund on the table, the Commission decides whether to pursue that option, and there is a theoretical possibility that he could benefit from the resolution of the matter. . . . In theory, David [Becker] could benefit from the Commission's resolution of the matter, which is why I recommend that he recuse." *Id.* In that case, the basis for recusal was a "theoretical possibility" of some benefit to Becker, which could be considered more speculative than the situation presented by Becker's participation in the Madoff Liquidation.[92]

In a case involving another large bankruptcy proceeding, in November 2009, the Ethics Office, including Lenox, considered potential recusal of Becker and then-Deputy General Counsel Cahn from the Lehman Brothers bankruptcy, which was also proceeding under SIPA. Ex. 189. In that case, OGC expressly told Ethics that "[t]he position [the SEC] would take could affect how much money the creditors generally recover. More narrowly, several creditors have filed objections to the position that we would recommend supporting." *Id.* Before responding to OGC, the Ethics Office staff discussed whether they needed "to learn the identity of the creditors, the customers (how

[91] Although Lenox testified that he continued to maintain that there was no appearance issue here, he did state that if he had known that there would be so much criticism of his decision, he would have factored that into his analysis. Lenox Testimony Tr. at 111-12.

[92] The creation of a Fair Fund would be the decision of the Commission or the hearing officer, who is designated by the Commission. Rules of Practice and Rules on Fair Fund and Disgorgement Plans, Rule 111 and 1100, *at* http://www.sec.gov/about/rulesprac2006.pdf.

broad do we go), and counsel for all?" *Id.* Lenox stated, "We need to learn the names of creditors who are parties because [OGC's] email says we will be affecting their interests. If customer parties are not affected by the brief I wouldn't go so broadly." *Id.* Assistant Ethics Counsel #4 responded, "But customers do seem to be affected – they are the other side of the argument: money goes one way or the other. Am I missing something, or is your note just asking whether the brief affects their interests, and if so, we need to know about the ones we know?" *Id.* Lenox responded: "I was just trying to clarify what effect their [*sic*] will be on customers. From what you are saying, we need the list of all parties and counsel." *Id.* Yet, with respect to Madoff, Lenox concluded that Becker simply would not be affected by the SEC's position in the Madoff Liquidation without considering the need for such a detailed analysis. Cahn and Becker ultimately were recused from the Lehman bankruptcy. Ex. 190; Becker Testimony Tr. at 34.[93]

Becker himself also took a more conservative stance on recusal in certain matters and even in one matter where the Ethics Office advised that he could participate. In July 2010, Becker discussed recusing himself from a Public Company B enforcement matter with the Ethics Office. The Ethics Office informed Becker that he previously was recused from this matter because of his holdings in both Public Company B and Public Company C, a company that was discussed in the memorandum to the Commission on the Public Company B matter. Becker responded, "I recused because of a brief (under 30 minutes) involvement with the case. Ultra conservative, but wise." Ex. 191. Similarly, in August 2010, the Ethics Office informed Becker that he no longer needed to be recused from a certain Public Company D matter, unless he had additional information that caused him to stay out. Ex. 192. The Ethics Office explained that recusal in his first year as General Counsel made sense because of the involvement of his then-former firm, but that if the law firm was the only covered relationship involved, he would now be free to participate as the year was over. *Id.* Becker responded, "I should stay out of this. I remember that I talked about it with the Cleary partner handling a piece of it. Whether that technically is ground for recusal, I want to stay clear of the case." *Id.* Finally, in March 2009, Becker stated that he did not "want to touch" a matter involving Public Company E. Ex. 193. The Ethics Office had noted that the amount of time he billed to Public Company E while in private practice was very limited (7.1 hours) and the consolidated entity issue involved is "sort of a big deal," and, accordingly, explained that the Chairman may be able to authorize his participation. *Id.*

F. Becker's Approach to SIPA Coverage for Stanford Investors Appeared to Differ from His Approach in the Madoff Liquidation

On February 17, 2009, the SEC brought a civil enforcement proceeding against R. Allen Stanford and three of his companies for operating a multi-billion dollar Ponzi

[93] Although OGC provided a list of key players from the phase of the litigation in which the SEC would be involved, it also informed the Ethics Office that "all the parties (creditors and customers) as well as their counsel" "[c]ould be millions of folks." Ex. 189. OGC also stated, "[T]here must be thousands of customers and maybe millions of customers, all of whom could be harmed or hurt to some degree depending on how the issue is resolved." *Id.*

scheme. SEC Press Release No. 2009-26, SEC Charges R. Allen Stanford, *Stanford International Bank for Multi-Billion Dollar Investment Scheme* (Feb. 17, 2009), http://sec.gov/news/press/2009/2009-26.htm. About six months later, SIPC President Harbeck sent a letter to the receiver appointed for the Stanford matter indicating that, based on the facts as set forth by the receiver, there was no basis for SIPC to initiate a proceeding under SIPA with respect to Stanford investors. Aug. 14, 2009 Letter from Harbeck to Janvey, http://www.stanfordfinancialreceivership.com/documents /SIPC_Letter.pdf.

The Commission began considering the legal question of SIPA coverage for Stanford investors while Becker was still at the Commission. Becker testified that he became involved initially in the SEC's considerations about SIPC coverage for Stanford investors, and although he was not at the agency when the Commission ultimately considered and decided the issue, he had an initial opinion as to the matter. Becker Testimony Tr. at 91. Becker testified that his "view was that SIPA, the statute, did not cover the Stanford situation."[94] *Id.* This view is consistent with contemporaneous documents indicating that Becker did not believe that SIPA provided coverage to Stanford investors.[95]

Becker also testified that, with respect to SIPA coverage for Stanford investors, "[his] view was also that it didn't make sense that it would not cover something like Stanford, but cover Madoff. But the law is the law." *Id.* at 91-92. By contrast, when considering the net equity issue in the Madoff Liquidation, Becker considered a variety of approaches in order to, as Becker testified, "take the position wh[ich] got the most money [to] injured investors consistent with the law." *Id.* at 53-54.

After Becker left the Commission, on June 15, 2011, the Commission concluded that certain Stanford investors were legally entitled to SIPA protection. SEC Press Release No. 2011-129, *SEC Concludes That Certain Stanford Ponzi Scheme Investors Are Entitled to Protections of SIPA* (June 15, 2011), http://www.sec.gov/news/press/ 2011/ 2011-129.htm. In addition, the SEC provided to SIPC an analysis explaining why SIPA coverage would apply to certain Stanford investors and authorized its staff to file a federal court action under SIPA to compel SIPC to initiate a liquidation proceeding, in the event SIPC does not do so. *Id.*

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[94] *See also* Sr. TM Official Testimony Tr. at 111 ("My understanding of David Becker's position was that Stanford should not be liquidated under SIPA. It didn't qualify as a -- there weren't customers under SIPA that needed to be protected.").

[95] *See, e.g* Ex. 194 (discussing Stanford coverage in response to a question from the Chairman as to SIPA coverage and stating, among other things, "That's why the [court's decision in the *Old Naples* case] doesn't compel the conclusion that SIPA provides coverage here. But the more fundamental reason has to do with the nature of the injury that Congress was protecting against here. From the standpoint of the investors, it doesn't make a difference; they are equally screwed. But the statute is what it is."); Ex. 195 (providing comments to a draft action memorandum proposing, "Unless the Commission directs otherwise, the staff does not intend to take steps to bring about a liquidation of broker-dealer Stanford Group Company under the Securities Investor Protection Act of 1970.").

G. The Ethics Office Advised Recusal from Madoff-Related Matters for Persons Other than Becker

The OIG investigation found that the Ethics Office considered recusals in Madoff-related matters differently in situations that did not involve Becker. Shortly after Madoff confessed, Lenox, as Ethics Counsel, sent a memorandum to all Commission employees regarding mandatory recusal from SEC v. Madoff in a broad variety of circumstances. Ex. 196. The memorandum stated as follows:

> [A]ny member of the SEC staff who has had more than insubstantial personal contacts with Bernard L. Madoff or Mr. Madoff's family shall be recused from any ongoing investigation of matters related to SEC v. Madoff. . . . Given the extreme importance and sensitivity of the Madoff matter, and the potential perception that staff contact and relationships with the Madoff family and firm may have influenced staff actions with regard to the firm, the Chairman has determined that, in these exceptionally unusual circumstances, a reasonable person would be likely to question the impartiality of any staff member who has had more than insubstantial personal contacts with Mr. Madoff or his family.

Id. The memorandum further set forth certain contacts that required recusal, including certain aspects of a personal friendship with Madoff or any other members of his family and a personal friendship with Eric Swanson, who was a former Assistant Director in the SEC's Office of Compliance Inspections and Examinations. *Id.* With respect to Swanson, contacts requiring recusal included an invitation to his wedding, gifts to and from him or his wife, visits to his home, or personal contacts on a more than quarterly basis. *Id.* With respect to Madoff, contacts requiring recusal included being invited to or visiting his homes or being an active member of the same social or charitable organizations. *Id.* Lenox testified that looking back, this memorandum "went beyond what [his] judgments would have been, but [he] was acting at the direction of the chairman." Lenox Testimony Tr. at 92. Lenox further stated that he would not have made recusal "[b]e so mandatory" and would have allowed for consideration of an individual's circumstances. *Id.* at 92-93.

1. Other OGC Attorneys Were Recused From the Madoff Liquidation

The OIG investigation further found that with respect to employees within OGC besides Becker, the Ethics Office took a more conservative approach for recusal from Madoff-related matters, including the Madoff Liquidation. The Ethics Office advised OGC Sr. Counsel #1, who at the relevant time was a Staff Attorney in OGC, that she had a conflict from working on any aspect of the Madoff Liquidation. OGC Sr. Counsel #1

testified that she spoke to Assistant Ethics Counsel #3 on multiple occasions about her potential participation in the Madoff Liquidation, stating:

> [T]hen I spoke to him after this about working on other parts of the Madoff case during that one year period if that would be possible. And he said no, that's not something you should do. And my final conversation with him before I was suppose [*sic*] to possibly begin working on the net equity appeal brief I said, you know what, I realize that I spent a very small amount of time in private practice working on a question related to the Madoff bankruptcy. I really remember very little about it other than it related to Madoff. And he just said we consider that to be the same matter and you cannot work on this at all. And that was our last conversation about it.
>
> Q. When you say this at all, you mean any aspect of the Madoff liquidation?
>
> A. Yes.

OGC Sr. Counsel #1 Testimony Tr. at 11-12.[96] Based on her conversations with Assistant Ethics Counsel #3, OGC Sr. Counsel #1 understood the Ethics Office position to be that if you worked on a very small aspect of Madoff related matters in your law firm, even if it was a small aspect, that would be considered part of the larger Madoff matter, and you would be conflicted from working on any Madoff Liquidation matter for the SEC. OGC Sr. Counsel #1 Testimony Tr. at 12.

OGC Sr. Special Counsel, who was during the relevant time period in OGC, understood that she should recuse herself from all aspects of the Madoff Liquidation. OGC Sr. Special Counsel had a personal friendship with Eric Swanson, and upon receipt of the December 24, 2008 memorandum discussed above, determined that she was recused from the Madoff matter. OGC Sr. Special Counsel Testimony Tr. at 12-14. Thereafter, she was copied on a draft action memorandum regarding the claims bar date in the Madoff Liquidation. Ex. 197. After receiving that memorandum, OGC Sr. Special Counsel sent an e-mail to Lenox and Assistant Ethics Counsel #3 stating that she was "recused on Madoff [because] of [her] contacts with Eric Swanson" and asking whether she was "also recused from this, SIPC, aspect?" *Id.* She also indicated that she had provided some general thoughts on SIPA to others in OGC but "hadn't focused on the

[96] Prior to the two conversations described in this excerpt, OGC Sr. Counsel #1 received ethics advice that she should not work on the customer definition aspect of the Madoff Liquidation because she noticed involvement of her former law firm and clients on that issue. She had left her firm less than one year previously and, therefore, was subject to a one-year ban from working on matters involving her former firm. OGC Sr. Counsel #1 Testimony Tr. at 9-11.

fact it was with regard to Madoff investors." *Id.* Lenox advised her that she "should recuse from participation in anything to do with this particular memo" but not to be concerned about her prior general advice." *Id.* OGC Sr. Special Counsel testified that she now understands this advice to mean that she should not work on any aspect of the Madoff Liquidation. OGC Sr. Special Counsel Testimony Tr. at 22-23.

In the case of OGC Sr. Counsel #1, the OIG investigation found that the Ethics Office took the broadest possible view of the Madoff Liquidation, *i.e.*, that the entire liquidation constituted one matter for ethics purposes. In the case of OGC Sr. Special Counsel, the Ethics Office took an even broader view, advising her that she should be recused from issues raised in the Madoff Liquidation even though the basis for her recusal (her friendship with Swanson) had nothing to do with the Madoff Liquidation. By contrast, with respect to Becker, the Ethics Office defined the "matter" very narrowly and determined that it related only to the consideration of what constituted a "securities position" under SIPA.

2. Lenox's Consideration of Appearance Issues In Other Matters

In addition to drafting the "Appearances Matter" NewsGram discussed above, Lenox referred to appearance issues when providing ethics advice as Ethics Counsel. For example, when providing advice to an incoming senior official regarding deferred compensation from his prior employer, he stated: "[A]s a prudential matter and to avoid any appearance concerns, even if not technically a criminal violation of the financial conflict of interest statute, 18 USC 208, we would continue to keep you recused for so long as you were receiving any payments from" the former employer. Ex. 198. Similarly, in advising the incoming official whether he could participate in an insider trading matter involving his former employer, he stated:

> The issue here is one of 'appearance'. [The former employer's affiliate] had a role in arranging financing for the acquisition at issue, [the former employer's affiliate] and you . . . were involved in providing documents and information during the investigation. Even if the staff's review fails to turn up any evidence of wrongdoing on the part of anyone at [the former employer] or its affiliate, 'a reasonable person with knowledge of the relevant facts' might conclude that the SEC did not pursue anyone at [the former employer or its affiliate] because you are now [a SEC senior official], a position that carries with it a great deal of discretion. Given the scrutiny that the Commission, the Division, and you are under, I advise you to recuse.

Ex. 199. Lenox testified that he believed that recusal was appropriate in this situation, but that the Chairman ultimately authorized participation pursuant to the applicable OGE regulations because the need for him to participate in the matter outweighed the

appearance concern. Lenox Testimony Tr. at 94-95. Accordingly, Lenox considered appearance issues with respect to other senior officers and even advised them of such issues in writing. Notably, his May 2009 written ethics advice to Becker did not mention appearance considerations.

REQUEST FOR ETHICS GUIDANCE FROM OGE

On August 31, 2011, after completing an extensive review of e-mails and relevant documents and after conducting approximately 40 interviews of current and former SEC employees with knowledge of the facts and circumstances regarding the allegations relating to Becker, the OIG provided to the Acting Director of OGE a summary of the salient facts uncovered in the investigation, as reflected in this report. The OIG requested that OGE review those facts and provide the OIG with its opinion regarding Becker's participation in matters as the SEC's General Counsel and Senior Policy Director that could have given rise to a conflict of interest. Specifically, the OIG asked that OGE provide guidance on whether, based upon the relevant facts, Becker violated any provisions of the Standards of Conduct, and whether his conduct should be referred to criminal authorities based upon possible violations of a federal conflict of interest statute.

The summary provided to OGE detailed Becker's participation in determining what position to recommend to the Commission as the appropriate method of calculating net equity under SIPA in the Madoff Liquidation, including: meeting with representatives of customer claimants who advocated the Last Account Statement Method and with SIPC and the Trustee who advocated the Money In/Money Out Method; supervising and providing feedback to his staff as they drafted various memoranda and communications regarding which approach to recommend to the Commission; signing the final advice memorandum to the Commission on this issue; and appearing before the Commission to urge adoption of the Constant Dollar Approach. Additionally, the summary provided to OGE detailed Becker's participation in providing advice on a potential amendment to SIPA that would have severely curtailed the Trustee's ability to bring clawback suits, most notably that Becker provided comments on draft legislation to this effect and solicited comment from his staff and colleagues, but that he did not believe that his input rose to the level of advice because the legislative proposals were nothing more than "political noise" or "political grandstanding."

The OIG also provided information to OGE regarding Becker's knowledge of his mother's estate's Madoff account, the reasons why he believed a clawback suit against him was unlikely, the ethics advice he sought and received from the former SEC Ethics Counsel, and the clawback suit that was ultimately brought against him by the Trustee in the Madoff Liquidation. The summary provided to OGE included evidence obtained from SIPC officials and numerous SEC witnesses regarding the interrelationship between the method used to determine a claimant's net equity and clawback suits, in contrast to Becker's belief that there was no connection between net equity determinations and clawbacks. Finally, the summary set forth evidence obtained from SIPC, the Trustee and SEC staff regarding the likelihood that someone in a situation similar to Becker's would

be subject to a clawback suit, as well as evidence reflecting factors that the Trustee does or does not consider when bringing such a suit.

After reviewing the summary of facts provided by the OIG, the Acting Director of OGE provided the following guidance to the OIG: "It is [the OGE's Acting Director's] opinion, as well as that of senior attorneys on [his] staff, that certain matters [the OIG] discussed in the materials [the OIG] provided to OGE should be referred to the United States Department of Justice for its consideration. This regards, more specifically: (a) Mr. Becker's work as General Counsel on the policy determination of the calculation of net equity in connection with clawback actions stemming from the Madoff matter, and (b) Mr. Becker's SEC work on the proposed legislation affecting clawbacks."[97] Ex. 200. He also stated that the OGE attorneys' view was that "the materials provided to OGE contain information relevant to two elements of 18 USC 208, to the extent they evidence Mr. Becker's apparent personal and substantial participation in both of the particular matters above, and to the extent there is implicated a personal financial interest that could be impacted by Mr. Becker's participation in those matters. Nonetheless, the actual knowledge element of 18 USC 208, which would be required to establish a violation of that statute, remains a question of fact that can only be resolved in a court of law."[98] *Id.*

Based upon this guidance, the OIG is referring the results of its investigation to the United States Department of Justice, Criminal Division, Public Integrity Section.

CONCLUSION AND RECOMMENDATIONS

In addition, based upon the OIG's findings in this report, the OIG is recommending that, in light of David Becker's role in signing the October 28, 2009 Advice Memorandum and participating in the November 2009 Executive Session at which the Commission considered OGC's recommendation that the Commission take the position that net equity for purposes of paying Madoff customer claims should be calculated in constant dollars by adjusting for the effects of inflation, the Commission reconsider its position on this issue by conducting a re-vote in a process free from any possible bias or taint. Once the re-vote has been conducted, the Commission should advise the United States Bankruptcy Court for the Southern District of New York of its results and the position that the Commission is adopting.

The OIG also recommends with respect to the Ethics Office that:

(1) The SEC Ethics Counsel should report directly to the Chairman, rather than to the General Counsel.

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[97] The OGE Acting Director also noted that "OGE is precluded by law from making any determination that the criminal conflicts of interest laws may or may not have been violated." Ex. 200.

[98] OGE did not consider whether Becker's actions created the appearance of impartiality, as set forth in the Standards of Conduct because such an analysis would only be applicable to a sitting federal employee and Becker has left the Commission. Ex. 200.

(2) The SEC Ethics Office should take all necessary steps, including the implementation of appropriate policies and procedures, to ensure that all advice provided by the Ethics Office is well-reasoned, complete, objective, and consistent, and that Ethics officials ensure that they have all the necessary information in order to properly determine if an employee's proposed actions may violate rules or statutes or create an appearance of impropriety.

(3) The SEC Ethics Office should take all necessary actions to ensure that all ethics advice provided in significant matters, such as those involving financial conflict of interest, are documented in an appropriate and consistent manner.

In light of the foregoing, we are referring this matter to the Chairman of the SEC and the Ethics Counsel for implementation of our recommendations. In addition, we are providing copies of this report to Commissioners Elise Walter, Luis Aguilar, and Troy Paredes for informational purposes.

Submitted: /s Date: 9/14/2011
Office of Inspector General

Concur: /s/ Date: 9/16/2011
Office of Inspector General

Approved: Date: 9·16·11
H. David Kotz