

**UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

CHARLES MEDERRICK, ROBERT MICK and)
JUDITH WELLING, individually and on behalf of)
all those persons similarly situated.)

Plaintiffs,)

v.)

UNITED STATES OF AMERICA,)

Defendant.)

CASE NO.: 10-CV-08331-UA
(LTS)

JURY TRIAL DEMANDED

**FIRST AMENDED CLASS ACTION
AND INDIVIDUAL COMPLAINT**

Plaintiffs Charles Mederrick, Robert Mick and Judith Welling (collectively "Plaintiffs"), individually and on behalf of all those persons similarly situated, by their attorneys, allege the following based upon the investigation of counsel, except as to allegations concerning Plaintiffs, which are based upon personal knowledge. The investigation of counsel included, among other things, a review of public filings, media and news reports, and publicly available documents and other information.

NATURE OF THE ACTION

1. Through this state law negligence class action, Plaintiffs — individually and on behalf of all those persons (the "Class" or "Class Members") who invested in Bernard L. Madoff Investment Securities, LLC ("BLMIS"), directly or indirectly, between November 18, 1992 and December 10, 2008, inclusive (the "Class Period"), and who have filed administrative claims with the Securities and Exchange Commission ("SEC"), which have or will be denied — seek to recover damages caused by the grossly negligent acts of Defendant in connection with the SEC's

deficient review of complaints and information that Bernard Madoff ("Madoff") and BLMIS were operating a Ponzi scheme: specifically, the SEC repeatedly and grossly failed to adequately apprise itself of the basic facts concerning the allegations and failed to undertake any reasonable efforts to understand the allegations and information in the various complaints under review in order to determine what, if any, action was appropriate under the circumstances. In each instance, the SEC wholly disregarded the specific facts in the complaints and the allegations and information that Madoff and BLMIS operated a Ponzi scheme, in dereliction of its nondiscretionary duty to review carefully complaints and information concerning potential violations of the securities laws.

2. Like a board of directors under the business judgment rule, to shield its decisions from review, the SEC had to take the basic and routine steps of adequately apprising itself of the facts and reasonably understanding the allegations and information in the complaints under review before it could make any discretionary determinations or judgments regarding appropriate action. The SEC, however, was grossly negligent in this simple, nondiscretionary duty. It did not adequately review the facts nor reasonably understand the Ponzi scheme allegations presented in the numerous complaints provided to the SEC over the course of sixteen years, and as a consequence never took any action in response to the Ponzi scheme allegations.

3. The consequences for investors were catastrophic. After over sixteen years of complaints and tips provided to the SEC that Madoff was operating a Ponzi scheme, in December 2008, Madoff himself confessed to operating a Ponzi scheme only as the weight of increasing redemptions toppled his fraud, causing investors over \$60 billion in damages.

JURISDICTION AND VENUE

4. This action arises under the Federal Tort Claims Act, 28 U.S.C. §§ 2671, *et seq.* (“FTCA”) and common law. Pursuant to 28 U.S.C. § 2675(a), Plaintiffs submitted administrative claims to the SEC for the FTCA claim described herein. By letters dated May 14, 2010, the SEC denied Plaintiffs Robert Mick and Judith Welling’s claim. The SEC did not respond within the required six months to Plaintiff Charles Mederrick’s claim.

5. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§ 1331 and 1346(b).

6. Venue is proper in this District pursuant to 28 U.S.C. §§ 1402(b) and 1391(e)(2), insofar as a substantial part of the events giving rise to this action occurred within this District, including but not limited to the grossly negligent failure of the SEC to adequately apprise itself of the basic facts concerning the allegations in several complaints and to undertake any reasonable efforts to understand the allegations and information in the various complaints that Madoff and BLMIS were operating a Ponzi scheme. Venue is also proper in this District pursuant to 28 U.S.C. § 1391(e)(3), because at least one of the named plaintiffs resides in this District.

PARTIES

7. Charles Mederrick (“Mederrick”) is an individual and a resident of the State of New York. Mederrick invested in BLMIS, and suffered a loss when the Madoff fraud was disclosed.

8. Robert Mick (“Mick”) is an individual and a resident of the State of Florida. Mick invested in BLMIS, and suffered a loss when the Madoff fraud was disclosed.

9. Judith Welling (“Welling”) is an individual and a resident of the State of New York. Welling invested in BLMIS, and suffered a loss when the Madoff fraud was disclosed.

10. The United States of America is the federal government and is the proper party defendant under the FTCA in this action for damages resulting from the gross negligence of the United States Securities and Exchange Commission (“SEC”) and its agents and employees.

CLASS ALLEGATIONS

11. Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and 23(b)(3) on behalf of a class of all persons who suffered a loss from their investments in Bernard L. Madoff Investment Securities, LLC (“BLMIS”), directly or indirectly, between November 18, 1992 and December 10, 2008, inclusive (the “Class Period”), and who have filed administrative claims with the SEC, which have or will be denied. Excluded from the Class are the Defendant herein, the officers and employees of the SEC, members of their immediate families and their legal representatives, affiliates, heirs, successors or assigns, or predecessors in interest.

12. Members of the Class are so numerous that joinder of all of the members of the class is impracticable. Counsel for Plaintiffs has been contacted by, and advises, well over 100 victims of the SEC’s gross neglect in its consideration of various Madoff complaints. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court. While the exact number of Class Members is unknown at present and can only be ascertained by appropriate discovery, counsel has knowledge of hundreds of plaintiffs, and Plaintiffs believe there are thousands of members of the Class located throughout the United States and the rest of the World.

13. Plaintiffs' claims are typical of the claims of the members of the Class. Plaintiffs and all Class Members were similarly affected by Defendant's wrongful conduct and have sustained damages as a result of Defendant's gross negligence as alleged herein.

14. Plaintiffs will fairly and adequately protect the interests of the members of the Class. Plaintiffs retained counsel competent and experienced in class securities and general litigation, and intend to pursue this action vigorously. Plaintiffs have no interest that is contrary to or in conflict with the interests of the prospective members of the Class whom Plaintiffs seek to represent.

15. A class action is a superior method of adjudicating these claims, over all other available methods for the fair and efficient resolution of this controversy. There is no difficulty, and Plaintiffs have no knowledge of any difficulty, in the management of this action as a class action.

16. Common questions of law and fact exist as to all Class Members, and such common questions predominate over any questions solely affecting individual members of the Class, including:

- a. Whether this action is exempt from the doctrine of sovereign immunity under the Federal Tort Claims Act;
- b. Whether Defendant had a nondiscretionary duty to adequately apprise itself of the facts and reasonably understand the allegations and information in complaints to the SEC and under review concerning potential violations of the securities laws;

- c. Whether Defendant failed in such duty by not adequately apprising itself of the basic facts concerning the allegations or undertaking any reasonable efforts to understand the allegations and information in the various complaints under review that Madoff and BLMIS were operating a Ponzi scheme; and
- d. The extent of damages sustained by the Class Members and the proper measure of such damages.

FACTUAL ALLEGATIONS

17. Almost since the beginning in or around 1989, when Bernard Madoff started his multi-billion dollar Ponzi scheme, his operations raised suspicions and generated significant criticism, publicly and among various fund managers and industry analysts, and more important, prompted substantial complaints to the Securities and Exchange Commission ("SEC"). From 1992 until Madoff confessed in 2008, the SEC received six substantive complaints that raised significant and obvious red flags concerning Madoff's hedge fund operations through Bernard L. Madoff Investment Securities, LLC ("BLMIS"). These complaints should have led to questions about whether Madoff was actually engaged in trading or merely operating a massive Ponzi scheme.

18. Not once in sixteen years of complaints, however, did the SEC investigate Madoff for operating a Ponzi scheme. To date, and after a significant investigation by the Office of Inspector General, the SEC has proffered no intelligible explanation for its failure to even consider the complaints that Madoff was operating a Ponzi scheme. It is clear that the SEC was grossly negligent in its failure to adequately apprise itself of even the basic facts concerning the Ponzi scheme allegations and in its failure to undertake any reasonable efforts to understand the allegations and information in the various complaints. These duties were nondiscretionary and

necessary steps for the SEC to perform its basic mission to protect the investing public from fraud.

I. FOR OVER SIXTEEN YEARS THE SEC IGNORED — WITHOUT ANY INTELLIGIBLE BASIS — NUMEROUS AND CLEAR PONZI SCHEME COMPLAINTS AND INFORMATION AGAINST MADOFF

19. In June 1992, the SEC received complaints from customers concerning Avellino & Bienes, an investment firm, that it was offering “100%” safe investments with high and extremely consistent rates of return over significant periods of time for “special” investors. During the course of its investigation, the SEC learned that Avellino & Bienes’ funds were completely controlled and invested by Madoff. While the SEC suspected that Avellino & Bienes was operating a Ponzi scheme (necessarily through Madoff), and forced Avellino & Bienes to discontinue its operations and refund money to investors, the SEC never considered the possibility that the money that was used to pay back investors came from other clients as part of a larger Ponzi scheme by Madoff.

20. The SEC received information that was indicative of a Ponzi scheme, including evidence of consistent returns over a significant period of time without any losses, purportedly achieved by Madoff using a basic trading strategy of buying Fortune 500 stocks and hedging against the S&P index. But the SEC assembled an inexperienced team of investigators, supervisors and enforcement personnel that never considered the Ponzi scheme implications.

21. The SEC’s response to the information regarding Madoff was not based on any appreciation of the facts or understanding of the complaints and information against Avellino & Bienes and necessarily Madoff, but, as the SEC’s lead examiner stated, appears to have been influenced by Madoff’s reputation as a broker-dealer.

22. In May 2000, Harry Markopolos (then an investment portfolio manager at a well respected options trading firm) submitted an eight-page complaint proposing only two potential explanations for Madoff's returns: (1) "[t]he returns are real, but they are coming from some process other than the one being advertised, in which case an investigation is in order;" or (2) "[t]he entire fund is nothing more than a Ponzi Scheme." Markopolos' complaint explained that Madoff's returns were unachievable using the trading strategy he claimed. He also noted that Madoff did not allow outside performance audits. These were significant red flags indicating a potential Ponzi scheme. Markopolos then explained his analysis to the SEC at a meeting and encouraged the staff to investigate.

23. Both Markopolos and an SEC staff accountant testified that after the meeting it was clear that the SEC's Assistant District Administrator did not understand the information presented. As a consequence, the SEC did nothing, with no discernable explanation except that the responsible personnel simply did not understand.

24. In March 2001, Markopolos provided the SEC with a second complaint, which supplemented his 2000 complaint with updated information and additional analysis. Markopolos analyzed Madoff's returns against the S&P500, concluding that Madoff's "numbers really are too good to be true." Merely one day after receiving the complaint, the SEC refused to take any action. There was no sensible explanation for why Markopolos' complaint was disregarded.

25. In May 2003, the SEC received yet another detailed complaint against Madoff, this time from a different source, a reputable Hedge Fund Manager, in which he identified several red flags that he had identified while performing diligence on two Madoff feeder funds. The complaint detailed specific areas concerning Madoff's purported strategy and alleged returns that were indicia of a Ponzi scheme. For instance, he detailed that while Madoff claimed to trade

\$8-10 billion in options, he checked with some of the largest brokers and did not see that level of volume. It was a clear indication that Madoff was not trading.

26. Inexplicably, the SEC disregarded the Ponzi scheme allegations. The SEC merely investigated front-running, seemingly because, as the Associate Director of the OCIE's broker-dealer examination group stated, "that was an area of expertise for my crew." Indeed, the Ponzi scheme allegations were not considered. The SEC did not seek interdepartmental assistance to attempt to understand the facts and the Ponzi scheme allegations against Madoff, even though the issues raised in the complaint addressed mainly investment management issues.

27. The staff assigned was an inexperienced team of mostly attorneys, who lacked substantial experience in equity or options trading.

28. As to the Ponzi scheme allegations, the SEC did nothing. The SEC failed to consider the facts that indicated a Ponzi scheme, including the unusual fee structure; the inability to see the volume of options in the marketplace; the remarkable returns; the fact that Madoff's trading strategy was not duplicable; the returns had no correlation to actual equity markets; the accounts were in cash at month's end; there were no third party brokers; and the auditor of Madoff's firm was a related party.

29. In April 2004, the SEC discovered emails during the course of a routine examination of an unrelated registrant that raised questions about Madoff's operations, specifically, Madoff's incredible and highly unusual fills for equity trades; misrepresentation of his options trading; secrecy; auditor; unusually consistent and non-volatile returns over several years; and fee structure. One of the emails even provided a step-by-step analysis of why Madoff must be misrepresenting his options trading, given the insufficient volume on an exchange and

the inconceivability that he could find an over-the-counter party because they would be continually losing money.

30. Once again, although significant facts indicating a Ponzi scheme were raised, the SEC simply ignored them. The SEC again only investigated front running.

31. During its front-running investigation, and after having caught Madoff in a number of misrepresentations, the staff sought to turn attention to issues related to Madoff's hedge fund operations and went to their supervisor for permission. Without any reasoned basis or any understanding of the facts, the assistant director denied their request. The SEC never understood nor made any effort to understand how Madoff achieved his returns or addressed the Ponzi scheme related allegations of the complaint.

32. In October 2005, Harry Markopolos sent a third complaint to the SEC entitled "The World's Largest Hedge Fund is a Fraud." The complaint detailed some 30 red flags that indicated that Madoff was operating a Ponzi scheme (or, "unlikely" front running).

33. The SEC did not adequately review the facts and allegations in the complaint concerning an alleged Ponzi scheme. Instead, the examiners, based ostensibly on personal bias and personality conflicts, expressed skepticism and disbelief concerning the complaint. Rather than focus on the facts and allegations against Madoff, the examiners questioned Markopolos' motives and maintained their skepticism without any rational basis.

34. The only reason the SEC seemed to disregard the facts and allegations for the sixth time was that they expressed "an inherent bias towards [the] sort of people who are seen as reputable members of society."

35. In addition, the SEC examination team that had previously investigated Madoff falsely and incorrectly claimed that Markopolos' complaint was "basically some of the same

issues we investigated” and that Markopolos “doesn’t have the detailed understanding of Madoff’s operations that we do which refutes most of his allegations.” The examiners later recanted their false claims, admitting that their examination “did not refute Markopolos’ allegations regarding a Ponzi scheme.”

36. Again, the SEC disregarded the allegations of a Ponzi scheme without any review or appreciation of the facts or understanding of the complaint. It merely examined whether Madoff should register as an investment advisor, disregarding the actual complaints submitted.

37. Nonetheless, Markopolos repeatedly attempted to provide the SEC with more useful information and contacts. The branch chief declined to even pick up the “several inch thick file folder on Madoff” that Markopolos offered.

38. While the enforcement staff did seek the assistance of the Office of Economic Analysis (“OEA”), they failed to provide the OEA with a copy of the Markopolos complaint.

39. In addition, the SEC failed to consult their own experts on broker-dealer operations, the Division of Trading and Markets, who could have facilitated inquiries with third parties, when it was clear that the examination team did not understand Madoff’s purported trading strategy, basic custody of assets issues, or even how Madoff’s operation worked. Indeed, prior to taking Madoff’s testimony, the Vice President and Deputy Director of the NASD Amex Regulation Division told the enforcement staff that they “needed to do a little bit more homework before they were ready to talk to [Madoff],” as it was clear that the staff did not understand enough about the subject matter.

40. The SEC never considered the Ponzi scheme allegations, but again simply ignored them.

41. Markopolos tried yet again in June 2007 to warn the SEC, sending an email to the branch chief attaching “some very troubling documents that show the Madoff fraud scheme is getting even more brazen” and noting “When Madoff finally does blow up, it’s going to be spectacular, and lead to massive selling by hedge fund, fund of funds as they face investor redemptions.” His email was ignored.

42. On December 10, 2008, after increasing redemptions pushed his scheme beyond the limit, Madoff was forced to admit his business was illegitimate. At his Manhattan apartment, he disclosed to two senior employees that his operation was “all just one big lie” and that it was “basically, a giant Ponzi scheme.” He was taken into custody by the Federal Bureau of Investigation the next day and charged for his crimes. He estimated that his fraud caused losses of approximately \$50 billion.

COUNT I — NEGLIGENCE

43. The SEC had a nondiscretionary duty to adequately apprise itself of the facts and reasonably understand the allegations and information alleged in the complaints under review regarding potential violation of the securities laws.

44. Over several years, the SEC received numerous complaints and information that Madoff and BLMIS were operating a Ponzi scheme. In each instance, the SEC failed to adequately apprise itself of the facts or to reasonably understand the Ponzi scheme allegations. Instead, the SEC serially disregarded the Ponzi scheme allegations. It merely investigated Madoff only for potential front running and failing to register as an investment advisor.

45. Never did the SEC make any determinations or give any consideration to the Ponzi scheme allegations in the complaints and information they received. They were simply overlooked, never considered or understood, in derogation of the SEC’s duty to adequately

apprise itself of the facts and reasonably understand the allegations and information in complaints under review of potential violations of the securities laws, and in an extreme departure from the duty of care customarily exercised under the circumstances.

46. Madoff later confessed to operating a Ponzi scheme, the biggest multi-billion dollar scheme in United States history. In subsequent investigations, the SEC has never put forward any reason for its failure to review the facts raised in the Ponzi scheme allegations and complaints. The SEC's actions enabled Madoff to continue to operate his Ponzi scheme during the Class Period, defrauding investors.

47. As a direct and proximate cause of Defendant's conduct, Plaintiffs and members of the class suffered substantial damages.

JURY DEMAND

48. Plaintiffs, individually and on behalf of the Class, demand a trial by jury on all issues so triable.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs demand judgment from the Court:

- a) certifying this action as a class action;
- b) awarding compensatory damages in an amount to be proven at trial, together with interest thereupon;
- c) awarding reasonable attorneys' fees, expenses, and costs incurred in connection with the institution and prosecution of this action;
- d) and awarding such other and further relief the Court deems just and appropriate under the circumstances.

November 11, 2010

Respectfully submitted,

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AO 440 (Rev. 12/09) Summons in a Civil Action

UNITED STATES DISTRICT COURT

for the

Southern District of New York

CHARLES MEDERRICK, ROBERT MICK and
JUDITH WELLING,

Plaintiff

v.

UNITED STATES OF AMERICA

Defendant

Civil Action No. 10-CV-08331-UA (LTS)

SUMMONS IN A CIVIL ACTION

To: *(Defendant's name and address)* UNITED STATES OF AMERICA
c/o United States Attorney for the Southern District of New York
86 Chambers Street
New York City, NY 10007

A lawsuit has been filed against you.

Within 21 days after service of this summons on you (not counting the day you received it) — or 60 days if you are the United States or a United States agency, or an officer or employee of the United States described in Fed. R. Civ. P. 12 (a)(2) or (3) — you must serve on the plaintiff an answer to the attached complaint or a motion under Rule 12 of the Federal Rules of Civil Procedure. The answer or motion must be served on the plaintiff or plaintiff's attorney,

whose name and address are: Dr. Gaytri D. Kachroo
Kachroo Legal Services, P.C.
219 Concord Avenue
Cambridge, MA 02138

If you fail to respond, judgment by default will be entered against you for the relief demanded in the complaint. You also must file your answer or motion with the court.

CLERK OF COURT

Date: _____

Signature of Clerk or Deputy Clerk