BERNARD MADOFF, MARITAL AGREEMENTS, MUTUAL MISTAKE[1]

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Disclosure in matrimonial actions is a matter of public policy.[2] Parties are required to present, inter alia, documents indicative of their financial holdings, such as, institutionally generated portfolio statements whose accuracy and reliability are typically never challenged. In 1991, the First Department, in *Elkaim v. Elkaim*,[3] broke critical evidentiary ground by allowing courts to take judicial notice of institutionally generated financial statements as an exception to the hearsay rule. The Appellate Division stated that their "*authenticity cannot be seriously challenged*" and appear "*patently trustworthy* as to be self-authenticating" because their "format conform[s] to the type of statements with which banks customarily supply their customers on a monthly basis for the purpose of advising them of deposits, withdrawals and balances." The victims of Bernard Madoff received such institutionally formatted statements, albeit criminally fraudulent, on a monthly basis for approximately two decades.

Simkin v. Blank,[4] a jarring Supreme Court decision, poses devastating consequences for divorcing couples who, unaware of Madoff's criminal enterprise, relied upon the accuracy of fraudulently generated portfolio statements.

***Simkin*: Complaint**

Nearly three years after dividing their marital property in a settlement agreement, plaintiff learned that they had suffered severe losses as unwitting victims of Madoff's fraud. Under their agreement, plaintiff retained, inter alia, sole ownership of all bank, brokerage and financial accounts in his name. Defendant kept, inter alia, the bank and investment accounts in her name, in addition to which plaintiff gave her $6,250,000, which included half of what was believed to have been in the Madoff account.

Plaintiff sued to reform the agreement with his former wife, contending that she should shoulder 'her share' of the harm he suffered. The Complaint laid out two causes of action: (1) mutual mistake, that, unbeknowst to them at the time of their agreement in 2006, plaintiff's investment with Bernard L. Madoff Investment Securities did not exist; and (2) restitution for unjust enrichment, because defendant unfairly profited from the mutual mistake. He alleged that their intent to distribute the assets equally was thwarted by their mistaken belief that their

[1] March 15, 2010; **Reprinted:** New York Family Law Monthly, Vol. 11, No., 9, May 2010 and Vol. 11, No. 10, June 2010.

[2] Richter v. Richter, 131 A.D.2d 453 (2nd Dept.,1987).

[3] Elkaim v. Elkaim, 176 A.D.2d 116 (1st Dept., 1991), appeal dismissed, 78 N.Y.2d 1072 (1991).

[4] 12/24/2009 N.Y.L.J. 1, (col. 3).

investment with Madoff was worth $5.4 million, while their account was, in fact, non-existent because Madoff had never engaged in any stock trades – the account held no assets and was "a fiction."

Defendant moved to dismiss the Complaint based on documentary defense, i.e., the numerous releases, and plaintiff's failure to set forth a cause of action for mutual mistake. Supreme Court dismissed the Complaint.

Mutual Mistake

Fundamental to this analysis is that interspousal agreements are contracts subject to principles of contract construction and interpretation.[5] Releases, as contracts whose interpretation is governed by principles of contract law,[6] may be set aside for mutual mistake.[7] Mutual mistake furnishes the basis for reformation and rescission when parties have reached an oral agreement and, unknown to either, the signed writing does not express that agreement.[8] The term 'mistake' may be used to cover all kinds of mental error, however induced.[9]

Reformation requires that the mutual mistake was material, i.e., it must involve a fundamental assumption of the contract; a party need not establish that the parties entered into the contract because of the mutual mistake, only that the material mistake . . . vitally affects a fact or facts on the basis of which the parties contracted.[10] The idea is that the agreement as expressed, in some material respect, does not represent the "meeting of the minds" of the parties[11] and neither side should profit from a mistake jointly perceived and acted upon.[12] An objective test is used to determine whether there has been a mutual mistake.[13]

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[5] Meccico v. Meccico, 76 N.Y.2d 822 (1990).

[6] Metz v. Metz 175 A.D.2d 938 (3rd Dept.,1991)**;** Goode v. Drew Bldg. Supply, Inc., 266 A.D.2d 925 (4th Dept., 1999); Greenebaum v. Barthman 210 A.D.2d 160 (1st Dept. 1994).

[7] Mangini v. McClurg, 24 N.Y.2d 556 (1969).

[8] Chimart Associates v. Paul 66 N.Y.2d 570 (1986); Book v. Book 58 A.D.3d 781 (2nd Dept.,2009).

[9] Rosenblum v. Manufacturers Trust Co. 270 N.Y. 79 (1936).

[10] True v. True 63 A.D.3d 1145 (2nd Dept., 2009).

[11] Carney v. Carozza, 16 A.D.3d 867 (3rd Dept., 2005); Brauer v. Central Trust Co. 77 A.D.2d 239 (4th Dept., 1980), lv. to appeal denied, 52 N.Y.2d 703 (1981).

[12] D'Agostino' v. Harding 217 A.D.2d 835 (3rd Dept., 1995).

[13] Ryan v. Boucher 144 A.D.2d 144 (3rd Dept.,1988).

In *Salomon v. North British & Mercantile Ins. Co. of New York*,[14] the Court of Appeals stated: "The mistake or each mistake must be shared in by both parties. The courts cannot compel ... any party, to enter into or be bound by a contract which it never made." It is beyond dispute that several million dollars is objectively material and neither party was aware of Madoff's scheme at the time of the agreement.

Supreme Court's next conclusion further strains law and logic: "In 2006, at the time of their agreement, each of the parties received the benefit of his and her bargain." This misses the essence of mutual mistake – while they then believed that they had a bargain mutual mistake of fact now reveals that Slimkin did not receive his end of the bargain because he bought out his wife's purported interest in the account.

Specific issues and contingencies are identified in specific merger clauses, not general merger clauses. Neither party had reason to question the legitimacy of Madoff's monthly account statements, thereby rendering it impossible to have contemplated "this" contingency. Simkin, a prominent attorney, anticipated that his investments would be impacted solely by market trends – he would never have signed an agreement which exposed him to an investment scam contingency, hence the absence of such a specific merger clause. A mutual mistake and a negotiated specific contingency cannot coexist. Supreme Court impermissibly fashioned a new contract by implying a specific merger clause into the agreement.

Furthermore, the wife had also accepted the Madoff statements as valid. Undoubtedly, had the situation been reversed, or had Madoff's investments been legitimate and the statements had erroneously reflected a reduced value, she would have brought the action to vacate the agreement under mutual mistake.

Releases, **Mutual Mistake**

The court focused on "the multiple comprehensive mutual releases" in the agreement, that the agreement was "in full and complete settlement of all claims including equitable distribution of all marital property," "in which each party relinquished all claim to the property of the other."

The theory of mutual mistake, when acted upon by the courts in refusing to give full effect to a general release, is based upon a determination or conclusion that the minds of the parties failed to meet in agreement upon the essential elements of the instrument – in such cases the courts say the release, though general in terms, was only intended to be a release of injuries known to the plaintiff at the time of settlement or execution.[15] Supreme Court even acknowledged Court of Appeals' precedent that a stipulation may be modified or rescinded

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[14] Salomon v. North British & Mercantile Ins. Co. of New York 215 N.Y. 214 (1915).

[15] Viskovich v. Walsh-Fuller-Slattery, 16 A.D.2d 67 (1st Dept., 1962), aff'd, 13 N.Y.2d 1100 (1963).

despite the releases it contains, where it is the product of a mutual mistake so material that it goes to the foundation of the agreement.[16]

Slimkin contended that the releases were limited in that the parties did not intend them to encompass the Madoff contingency. Supreme Court stated that "this limitation was nowhere expressed in the agreement, which sets forth repeatedly that each of the parties waived any claim to or upon the property of the other." However, expression of "this limitation" in the agreement is evidenced by the parties' conspicuous selection of general releases rather than specific merger clauses.

Equal Distribution

Simkin alleged that the parties' intended to share their assets equally as of September 2004, the date of their separation. Supreme Court incorrectly found it significant that the agreement did not recite this intention. No authority requires that such an intention be articulated within the body of an agreement. Moreover, the intent to equally divide their assets can be readily proved at trial with a calculator. In a marriage of over 30 years it is most improbable that the distribution would have been anything less than equal.

Illegal Transactions

The Court adopted the defendant's argument, which was made "without contradiction that on September 1, 2004, and later, on June 27, 2006 when the parties entered into their agreement, and [] for the several years thereafter that plaintiff maintained this investment, it could have been redeemed for cash, presumably significantly in excess of its 2004 value."

Where a party must trace the cause of action to an illegal transaction there can be no recovery.[17] Supreme Court's statement that the [Madoff] account "could have been redeemed for cash, presumably significantly in excess of its 2004 value", implicitly restructures Simkin's cause of action to necessarily trace back to not one illegal transaction but to many because, in a Ponzi swindle, fresh monies derived from later victims feed the earlier investors – the thief robs new Peter's to pay old Paul's. Simkin, like all Madoff's clients, held no existing discrete account with his own segregated funds that he could have redeemed.

Noelleen G. Wilder reported (NYLJ, March 2, 2010) that, in *In re Bernard Madoff Investment SecuritiesLLC*, 08-01789-brl, Southern District Bankruptcy Judge Burton R. Lifland underscored precisely this point in upholding a trustee's method of adjudicating the claims of defrauded Madoff investors :

> The [Madoff] books and records expose a Ponzi scheme where no securities were ever ordered, paid for or acquired. Because 'securities positions' are in fact nonexistent, the Trustee cannot discharge claims upon the false premise that

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[16] Da Silva v. Musso, 53 NY2d 543 (1981).

[17] Janke v. Janke, 47 A.D.2d 445 (4th Dept., 1975), aff'd, 39 N.Y.2d 786 (1976).

customers' securities are what the account statements purport them to be.

Nevertheless, in its dismissal of Simkin's complaint, the court disturbingly "punished" him for not having redeemed his investment with Madoff from what is now known to have been illegal monies because his account was nonexistent. It rattles the foundations of jurisprudence that a court, fully aware of Madoff's criminal enterprise, can, in good judicial conscience, rule that a litigant exhausted his judicial remedies for failure to have sought relief from a criminal.

CPLR 3016(b): Particularity

The court further found that Simkin failed to set forth his claim of mistake "with particularity, and the circumstances must be stated in detail [pursuant to] CPLR 3016(b)." Madoff confessed to everything. Supreme Court was required to take judicial notice of Madoff's crimes, Federal evidence of which Simkin properly annexed to his complaint. What more beyond that which the entire world learned about Madoff could Slimkin possibly have alleged with greater particularity? Simkin was held to an impossible standard.

Indistinctive Semantics

Supreme Court focused on Simkin's allegation that the account was "non-existent": "in the absence of a claim that, on the date of the[ir] agreement the account had no [redeemable] value the complaint fails to set forth a cause of action, either for mutual mistake or for unjust enrichment." "The claim of mistake [wa]s opaque, stating simply that the account [] did not exist." It is elementary that a non-existent account has no value. In practical terms, this distinction is meaningless and does not even rise to the level of subtle sophistry. The court did not even offer him any latitude under the rubric of inartful pleading. It exalted meaningless semantic distinctions over settled contract doctrine.

Supreme Court noted that Simkin "liquidated a portion of his investment at the time of the agreement in [] 2006 to fund the payment of defendant's equitable entitlement ... An investor's ability to redeem an account for value, was the assumption on which the parties relied in dividing their property and in doing so they made no mistake." However, at the time of the redemption, Simkin and the rest of the universe had no inkling of Madoff's scam. Simkin could thus not have known that the liquidated monies did not belong to him and derived from criminally diverted monies. It is beyond disturbing that this is the court's route of choice for Simkin.

Although Supreme Court acknowledged that "as one of Madoff's many victims, plaintiff has been unjustly harmed", it astonishingly concluded that "there [wa]s no evidence that defendant was unjustly enriched." As in algebraic equations, whatever operation is performed on one side of the equation must be performed on the other side. If Simkin was unjustly harmed, then defendant was unjustly enriched.

The Dictionaries

Supreme Court characterized Simkin's retention of the account as "improvident." The

second definition in Black's Law Dictionary defines "improvident" as "of or relating to a judgment arrived at by using misleading information or a mistaken assumption." In 2006 Madoff's investors considered their monthly statements a secure confirmation of their holdings – there had been no rumblings that Madoff's investors might have heeded.

Merriam-Webster defines improvident as "not foreseeing and providing for the future." It can hardly be argued that had Simkin been aware that Madoff had robbed him and that he alone would be left to sustain the consequences, that he would not have signed the settlement agreement. Again, there was no specific merger provision. He only chanced market conditions not robbery. How then did Supreme Court find improvidence?

***Etzion*'s Irrelevance**

Supreme Court cited *Eztion v. Eztion*, 62 AD3d 646 (1st Dept. 2009). I analyzed *Etzion* in a prior article, "Parallel Obligations of Disclosure and Investigation in Divorce Actions", NYLJ 9/11/09. *Etzion* is absolutely irrelevant herein. *Etzion* brought several doctrines into focus.[18] The first involved the question of a fraud claim and the victim's rightful/justifiable/reasonable reliance upon the misleading representation made by a party – that a burden of due diligence rests upon a party to confirm its accuracy if possessed of the means to do so.

Next *Etzion* involved the special facts doctrine where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge, creating a duty to disclose that information.

Finally, *Etzion* brings the doctrine of conscious ignorance, conscious negligence into light. Under this doctrine, a party may not seek to void an agreement by intentionally proceeding without further investigation of his or her rights but rather by forging ahead with "conscious ignorance" or "conscious negligence."

Significantly, neither party had made a knowingly fraudulent representation to induce the other's execution of the agreement. Second, neither party had any superior knowledge of the true facts. Third, neither party could have discovered Madoff's criminality independently. Madoff's confession, in December, 2008, stunned the U.S. Attorney and the financial world globally at the magnitude of the deception, which included the monthly production of meticulously false statements, across two decades, for each client. It is absurd to hold that any Madoff investor could have conducted an impossible due diligence single handedly. Furthermore, it creates an untenable standard that a court could have properly taken judicial notice of Madoff's pre-arrest monthly institutional client statements without further authetication, *à la Elakaim*, but it was improper for an investor to have done so. It is left to speculation as to how many trials and settlements, not necessarily confined to spousal litigation, relied upon Madoff's statements.

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[18] The citations for the herein discussion on *Etzion* appear in the aforementioned article.

Conclusion

Simkin is severely flawed. Simkin should have prevailed on the merits on summary judgment, much less withstand a motion to dismiss his Complaint. An erroneous inference from this ruling is that, barring an immediate joint liquidation of a Ponzi account where both parties face mutual exposure, the only protection in a *Simkin* situation, is a contractual hold harmless clause allowing rescission or reformation.

The Court of Appeals has emphasized that "stability of contract obligations must not be undermined by judicial sympathy."[19] That Simkin may appear less sympathetic as a greedy investor driven by market disproportionate returns does not condone perversion of settled contract doctrine and jurisprudence.

One is constrained to wonder, would the outcome have been the same had the wife retained the Madoff account and faced shouldering the $2.75 million loss herself?

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[19] First Nat. Stores, Inc. v. Yellowstone Shopping Center, Inc. 21 N.Y.2d 630 (1968).